

PREFATORY NOTE

These transcripts have been produced from the original raw transcripts in the FOMC Secretariat's files. The Secretariat has lightly edited the originals to facilitate the reader's understanding. Where one or more words were missed or garbled in the transcription, the notation "unintelligible" has been inserted. In some instances, words have been added in brackets to complete a speaker's thought or to correct an obvious transcription error or misstatement.

Errors undoubtedly remain. The raw transcripts were not fully edited for accuracy at the time they were produced because they were intended only as an aid to the Secretariat in preparing the records of the Committee's policy actions. The edited transcripts have not been reviewed by present or past members of the Committee.

Aside from the editing to facilitate the reader's understanding, the only deletions involve a very small amount of confidential information regarding foreign central banks, businesses, and persons that are identified or identifiable. Deleted passages are indicated by gaps in the text. All information deleted in this manner is exempt from disclosure under applicable provisions of the Freedom of Information Act.

Meeting of the Federal Open Market Committee

March 29-30, 1982

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D. C., beginning on Monday, March 29, 1982, at 4:00 p.m. and continuing on Tuesday, March 30, 1982, at 9:45 a.m.

PRESENT: Mr. Volcker, Chairman
Mr. Solomon, 1/ Vice Chairman
Mr. Balles
Mr. Black
Mr. Ford
Mr. Gramley
Mr. Partee
Mr. Rice
Mrs. Teeters
Mr. Wallich
Mr. Winn

Messrs. Guffey, Keehn, Morris, and Roos, Alternate Members of the Federal Open Market Committee

Mr. Martin, 2/ Vice Chairman designate, Board of Governors

Messrs. Boehne, Boykin, and Corrigan, Presidents of the Federal Reserve Banks of Philadelphia, Dallas, and Minneapolis, respectively

Mr. Axilrod, Staff Director
Mr. Altmann, Secretary
Mr. Bernard, Assistant Secretary
Mrs. Steele, Deputy Assistant Secretary
Mr. Bradfield, General Counsel
Mr. Mannion, 3/ Assistant General Counsel
Mr. Kichline, Economist

- 1/ Entered the meeting following the approval of the minutes of actions taken at the meeting on February 1-2, 1982.
- 2/ Entered the meeting on Tuesday prior to the action to adopt the domestic policy directive.
- 3/ Attended Tuesday session only.

Messrs. J. Davis, R. Davis, Ettin, Keran, Koch,
Parthemos, Prell, Siegman, Truman, and Ziesel,
Associate Economists

Mr. Sternlight, Manager for Domestic Operations,
System Open Market Account

Mr. Cross, Manager for Foreign Operations, System
Open Market Account

Mr. Coyne, Assistant to the Board of Governors

Mr. Gemmill, Associate Director, Division of
International Finance, Board of Governors

Mr. Kohn, Senior Deputy Associate Director, Division of
Research and Statistics, Board of Governors

Mr. Lindsey, Assistant Director, Division of Research
and Statistics, Board of Governors

Mrs. Deck, Staff Assistant, Open Market Secretariat,
Board of Governors

Mr. MacDonald, First Vice President, Federal Reserve Bank
of Cleveland

Messrs. Balbach, Burns, T. Davis, Eisenmenger, Mullineaux,
Scheld, and Stern, Senior Vice Presidents, Federal
Reserve Banks of St. Louis, Dallas, Kansas City,
Boston, Philadelphia, Chicago, and Minneapolis,
respectively

Messrs. Sandberg, and Soss, Vice Presidents, Federal
Reserve Bank of New York

Transcript of Federal Open Market Committee Meeting of
March 29-30, 1982

March 29, 1982--Afternoon Session

CHAIRMAN VOLCKER. We have some items to take care of at the beginning of this meeting. First, the election of officers. We need to nominate a Chairman and a Vice Chairman in case you--

MR. WALLICH. Well, I shall undertake this heavy responsibility. I propose and nominate Paul A. Volcker.

CHAIRMAN VOLCKER. Is there a second?

MR. PARTEE. I'll second that.

CHAIRMAN VOLCKER. Are there any other nominations? If not, we assume we have a Chairman and I'm the Chairman. We need a Vice Chairman.

MR. WALLICH. Well, I propose and nominate in his absence Anthony M. Solomon.

CHAIRMAN VOLCKER. Apparently, Anthony M. Solomon missed the shuttle. I don't know whether that's appropriate for a Vice Chairman! Do we have a second?

MR. PARTEE. I'll second that.

MR. BOEHNE. Is this a rigged election?

CHAIRMAN VOLCKER. If I hear no objection, we will proceed. I have a list of a good many staff members as proposed officers that I would ask the Secretary to read, including Mr. Altmann as Secretary.

MR. ALTMANN.

Staff Director, Stephen Axilrod
Secretary, Murray Altmann
Assistant Secretary, Normand Bernard
Deputy Assistant Secretary, Nancy Steele
General Counsel, Michael Bradfield
Deputy General Counsel, James Oltman
Assistant General Counsel, Robert Mannion
Economist, James Kichline

Associate Economists from the Board's staff:
Edward Ettin;
Michael Prell;
Charles Sigmann;
Edwin Truman; and
Joseph Zeisel.

Associate Economists from the Reserve Banks:
John Davis, Cleveland;
Richard Davis, New York;
Michael Keran, San Francisco;
Donald Koch, Atlanta; and
James Parthemos, Richmond.

CHAIRMAN VOLCKER. Would someone like to move those?

MR. PARTEE. So moved.

MS. TEETERS. Second.

CHAIRMAN VOLCKER. If there are no objections, we will have the officers duly installed as of this moment. We need a Reserve Bank to operate the System Account.

MR. WALLICH. I propose the Federal Reserve Bank of New York.

CHAIRMAN VOLCKER. Do we have a second?

MR. PARTEE. Second.

CHAIRMAN VOLCKER. With no objection. We need a Manager for Domestic Operations and a Manager for Foreign Operations; perhaps someone would like to nominate both at the same time.

MR. WALLICH. I nominate Peter Sternlight and Sam Cross.

MR. PARTEE. Second.

CHAIRMAN VOLCKER. Objections? In the absence of any objections, it's unanimous. I'm skipping now to the end of the agenda you have--we might as well get this all out of the way--to the review of the domestic authorization and the foreign currency instruments. Nobody has proposed any changes in those. Does anybody have any objections or questions on that second, or third part? If not, hearing no objections, they are approved. As for the authority for lending securities from the System Open Market Account, we've been renewing this for some years. Any comments? I take it there was some suggestion earlier to make this permanent. Does anybody want to talk to that point?

MR. PARTEE. To make what permanent?

CHAIRMAN VOLCKER. The lending [authorization] that now has to be approved every [year].

MR. PARTEE. I thought we had to make a determination on this, Mr. Chairman, as to whether it is necessary [for the effective functioning of] the market. Isn't that right, Peter?

MR. STERNLIGHT. That's right. I think the judgment could be made [that it's necessary] on a continuing basis. I don't know that there is anything in the legal basis on which it was set up that required an annual determination of that kind and, therefore, I have suggested in my memorandum to the Committee, which Mr. Bradfield supported, that it could be incorporated in the continuing authorization for operations.

CHAIRMAN VOLCKER. And we approve that every year anyway, don't we?

MR. STERNLIGHT. That's right, yes.

CHAIRMAN VOLCKER. As nearly as I can see, no major policy issue is involved. It gets approved every year anyway. I guess it's just a question of which document we put it in.

MR. BLACK. We might have to bring up only one agenda item next year!

CHAIRMAN VOLCKER. I think that's the net difference involved here. I have no strong conviction on this point. Does anybody have any conviction?

MR. BLACK. I don't see any reason for not doing it.

CHAIRMAN VOLCKER. Do you want to propose it?

MR. BLACK. I so propose.

MR. MORRIS. Second it.

CHAIRMAN VOLCKER. If we have no objection,--

MR. PARTEE. I take it anyone who wanted to question it could put it on the agenda?

CHAIRMAN VOLCKER. My understanding is that it would be approved every year anyway. It's just a question of what document we're putting it in.

MR. STERNLIGHT. It's also the question of whether it is looked at separately by the Committee or considered as part of this entire authorization for domestic operations.

CHAIRMAN VOLCKER. Henceforth it will be part of the authorization. And we look at it separately anyway. That is approved. The final item is a review of the agreement with Treasury to warehouse foreign currencies. I have had no comments on that reported to me. I hear no objections to the warehousing agreement. That will be approved. I guess I skipped over the foreign currency authorization, the foreign currency directive, and the procedural instructions. On the review of those, again, I have heard no comments. If there is no objection at this time, they will be approved. So, all this is unanimously approved. We can now be very, very approving of the minutes, I guess. Do I have a motion on the minutes?

MR. PARTEE. So moved.

CHAIRMAN VOLCKER. Without objection, the minutes are approved. With that out of the way, we will have a report on foreign currency operations. Mr. Cross.

MR. CROSS. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Comments or questions?

MR. WINN. What is the status of the Polish financing? Doesn't that come up at the end of this month again?

MR. TRUMAN. No, next week.

CHAIRMAN VOLCKER. I'm not sure I follow your explanation as to why the yen is so weak. Would you--

MR. CROSS. The yen is weak. I'm not sure I have an extremely compelling explanation. One factor has been that, while we're all expecting the Japanese to have a very large current account surplus this year, the recent figures have not been that rosy. They have not shown a very strong current account position in the past couple of months. Another factor, I think, is that people are concerned that the rest of the world is going to take steps to reduce access to Japanese goods. The EC has talked about bringing this matter up under GATT and they have brought it up under GATT. There is, of course, legislation in our Congress which would apply a bilateral reciprocity rule to it. Now, whether these are the factors that have resulted in this effect, I can't say. The yen has been very, very weak and I'm not sure those explanations would be completely convincing. But they are factors in it.

CHAIRMAN VOLCKER. We have a lot of things to worry about and that's one that I worry about a bit.

MR. WINN. Could I raise one more question, Mr. Chairman? What's the status of Mexico, with the devaluation?

MR. CROSS. Well, the devaluation by Mexico was certainly regarded initially as very useful--a successful move in that there were reflows of capital back into Mexico and a reversal of the dollarization that Mexico experienced. So, during the first few weeks there was a very rosy and successful view about it. But there has been a notable lack of a supporting program and increasing concern about the lack of such a program. At the present time there has been a decree to increase wages by really very, very large amounts--amounts which almost nobody thinks can be justified by the devaluation. Mexico had a very large increase in the minimum wage in January of 33 percent. Another 30 percent has been proposed; the employers haven't yet agreed to all of this. So, that adds up to a [cumulative] 73 percent wage increase in the first 2 or 3 months of the year. And everybody is beginning to wonder how long the peso can remain at the level it now is with these kinds of wage increases and the expectation that inflation will run at 50 percent or so this year at a time when U.S. inflation is 7-1/2 percent or so. So, it appears that the initial reaction, which was so favorable, is now giving way to second thoughts. The reflows are perhaps tailing off and there is some concern about what is going to happen in the months ahead.

CHAIRMAN VOLCKER. What has the recent inflation rate been in Mexico?

MR. CROSS. In Mexico? The numbers that I received were 5 percent for the month of January, 4 percent for the month of February, and an expectation of 8 percent for the month of March. That's [over] 17 percent in the first 3 months, so most of the people who are making estimates have estimates for the year of between 45 and 65 percent.

CHAIRMAN VOLCKER. What was it last year?

MR. TRUMAN. The first 2 months of the year were before the devaluation.

MR. CROSS. Yes. The 8 percent reflected the devaluation. Last year it was about 30 percent.

CHAIRMAN VOLCKER. Any other questions or comments? If not, we'll go to the domestic open market operations.

MR. STERNLIGHT. [Statement--see Appendix.]

CHAIRMAN VOLCKER. There is so much talk in the market about this April [M1] issue, why don't you tell us what you know about April, Mr. Axilrod?

MR. AXILROD. Well, I was going to include a bit of it in my statement, Mr. Chairman, but our underlying estimate for April is somewhere between 8 and 10 percent, as you can see from the Bluebook. In our seasonal adjustment methodology, we have followed strictures given to us by the various academic groups who looked at our seasonal methodology--the last one being a group headed by Jeffrey Moore and including such people as the former Presidents of the American Statistical Association, and the august Mr. Box of Box-Jenkins. And they say avoid judgment. They also asked that it be reproducible outside and that we take into account a technique called an Arima method, which projects the unadjusted data for the year ahead on the basis of the past performance of the data to eliminate the revisions in the seasonal factor by getting a better sense of '82. So, this year we adopted the X-11 Arima method.

MR. ROOS. Wait 'til that gets out! [Laughter]

MR. AXILROD. If we had not adopted that method but had continued with our old X-11 without the Arima method, we would be allowing for about 7 percentage points more growth in April than we are now. If we had instead used the present method but unleashed our judgmental man, Mr. Fry, we would have allowed for 2 percentage points more growth. So, that presents a range perhaps of where we might be erring on predicting too low a growth. There are some odds, Mr. Chairman, that what we have done is correct, however.

CHAIRMAN VOLCKER. They're infinitesimal!

MR. AXILROD. I would point out that in that case one would look more at what we have judged to be the intrinsic error in the seasonal adjustment process. And at the 95 percent level, that's plus or minus 6 percentage points in any month, at an annual rate.

CHAIRMAN VOLCKER. Mr. Axilrod can only talk in annual rates, I'm beginning to think.

MR. AXILROD. So, in assessing the forthcoming situation for the Committee, we have tilted toward thinking that the seasonal might be understating the actual seasonal increase because of the difficulties of '80 and '81, and thus we are projecting 8 to 10 percent growth rates. If you think that we have understated by 5 percentage points, that would mean we're projecting 3 to 5 percent growth in some real sense. Now, if we are understating, it's probably the case that May and June will be a lot lower. It looks as if May and June would be mostly the times when, whatever error in the seasonal in this period, the curves would be taken out. April is a particularly difficult time.

CHAIRMAN VOLCKER. Why would it be May and June? Why wouldn't it be March and February?

MR. AXILROD. Just looking at the data judgmentally, it looked as if that's when it would be. April is a difficult month because we had the credit control program in 1980 and we had a very sharp decrease; and in 1981 we had a very sharp increase, part of which probably can be attributed to the preceding easing of monetary policy when interest rates went down some. The machines have a very difficult time with these extreme variations and we have done some [judgmental] intervention to smooth it in 1980, and these results reflect those interventions. Also, the machine throws out 1981, by the way.

MR. MORRIS. Very good machine!

MR. PARTEE. [Unintelligible] markets seem to be right.

MR. AXILROD. Well, I feel rather agnostic about it. I am not all that certain. If we follow the advice of a group of academic experts, at times we may be right. And we don't want to discount that [possibility].

MR. PARTEE. It's interesting. Are they aware of the fact that we've made these adjustments to our procedure? It seems these adjustments to procedure would lead one to expect a larger rise in April because of what has happened [in the] seasonal.

MR. AXILROD. Well, we have indicated how we make our seasonal adjustments to this. We explained the X-11 Arima. But, of course, the market has the same suspicions most of you and many on the staff have: That this still isn't sufficient allowance for the April seasonal.

CHAIRMAN VOLCKER. Well, it makes us a little suspicious. If I remember what you told me correctly, April in every year since 1975 has been higher, seasonally adjusted.

MR. AXILROD. That's correct.

CHAIRMAN VOLCKER. Except for 1980, which we threw out. And then 1981 gets thrown out by the machines.

MR. AXILROD. Well, we didn't throw 1980 out.

CHAIRMAN VOLCKER. The last two years aren't in there. And it looks as if--

MR. AXILROD. We didn't throw out 1980, Mr. Chairman. And there is really a technical problem. We intervened through a model to smooth through and--

CHAIRMAN VOLCKER. [Unintelligible] at the moment now.

MR. AXILROD. No, it lowered it. In effect, it put in a modest growth rate, which made the machine doubt the accelerated trend in '76 to '79.

CHAIRMAN VOLCKER. We're worse off than if you hadn't. It just would have thrown it out if you had left it alone.

MR. GRAMLEY. Is this specific seasonal for April in the public domain? Is that published?

MR. AXILROD. Yes.

MR. GRAMLEY. So the people in the market know what that number is?

MR. AXILROD. Oh, yes; that's right.

MR. GRAMLEY. Are you not saying that, although we expect something in the 8 to 9 percent range, we should relax until it's 12 to 14 percent or something like that?

MR. AXILROD. Well, I would relax myself if it were between 8 and 10 percent. I think you're getting on to strong policy judgments beyond that. I would not really want to give any technical advice on that particular point.

MR. BLACK. What kind of figures would it take for the market to relax?

MR. AXILROD. Again, it's hard to psychoanalyze people. But I would assume that they would understand that 8 to 10 percent might be the peculiarities of April and the difficulties of seasonally adjusting in the face of tax payments, refunds, and all that.

MR. STERNLIGHT. I don't know if it's so much a particular level. They might feel relaxed about 8 to 10 percent, but it's more whether they get some sense of how we're reacting to it that would make them feel easy or uneasy about it. I think even 8 to 10 percent could bother them if they felt it was causing us to keep reserve supplies more restricted.

MR. BLACK. Peter, what do you think the range of their projections is now?

MR. STERNLIGHT. I wouldn't be surprised if it were around this 8 to 10 percent range, but I haven't really heard enough to give a good accurate answer.

MR. BOEHNE. With the expectation so widespread that April is going to be a month with a bulge, wouldn't there be some discounting taking place at this point?

MR. STERNLIGHT. Yes, there is; it has been in the process of taking place these last couple of weeks or maybe even earlier. But it's partly this concern that there will be a big bulge that is leading some participants to have an expectation now of higher rates in the next few weeks.

MR. BOEHNE. Do you think the market is as M1 oriented as it always has been or are there increasing doubts, at least among some people, about M1? Are there doubts in the marketplace, too, [unintelligible]?

MR. STERNLIGHT. Well, I think they were impressed by the evidence of how the January situation was handled. They say that there was a bulge but that to some degree it was accommodated. They feel it was reacted to in the sense that rates did rise, but they feel, too, that it wasn't such a strong reaction--that we were [not] just determined that virtually at all cost we had to push money growth back to path. And some of the comments that the Chairman made at the congressional hearing, I think, supported that interpretation. I think they would expect a similar scenario if there were a bulge in April. They would be looking to see whether we would accommodate the bulge to some degree in the expectation of having it unwind pretty soon afterward.

VICE CHAIRMAN SOLOMON. We have to look alert but relaxed. When we get these bulges [unintelligible], affects the market reaction as to how they--

MR. CORRIGAN. Steve, you mentioned this 8 to 10 percent figure. What is the dollar increase in the not seasonally adjusted M1 number in [unintelligible]?

MR. AXILROD. Well, I don't think I have that with me. I have the seasonally unadjusted weekly pattern on another paper but I don't have that with me.

MR. STERNLIGHT. I think it's about 30 percent, isn't it, Steve?

MR. AXILROD. Yes, it's 40 percent.

MR. STERNLIGHT. Oh, 40! I thought I saw 30 percent.

MR. AXILROD. I don't have that; I can get it by tomorrow.

MR. CORRIGAN. That's a very big number now.

MR. AXILROD. Oh, yes.

SPEAKER(?). Well, there's a huge social security thing coming up again.

MR. GUFFEY. If you were using the old method, Steve, what would April have come out to--17 18, 20 percent, or something larger than that?

MR. AXILROD. No, if we keep the same unadjusted increases we now have and use the old X-11 method untampered by Arima, it would be something like 7 percentage points less than this 8 to 10 at an annual rate.

SPEAKER(?). If my understanding of that is right, it would be 1 or 2 percent?

MR. AXILROD. Well, that's a large number and we wouldn't have used it. But that's what it would be if we didn't change our unadjusted number. It allows for 7 percent at an annual rate more increase in money supply [for] the seasonal purposes alone. Instead of the money supply increase unadjusted being 40 percent at an annual

rate in April it would have allowed for 47 percent. That's well above what it has been.

MR. GRAMLEY. The old method put that out? I thought I had understood you to say the opposite at first.

MR. AXILROD. No.

MR. GRAMLEY. I thought you said the X-11 Arima method assumes a larger seasonal bulge in April.

MR. AXILROD. No, smaller.

MR. PARTEE. That's the reason I asked if the market knew we were doing all this. [If] not, they might conclude there's going to be a large seasonally adjusted rise in April.

MR. STERNLIGHT. I don't think the market knows it for that reason. I think they believe it just [on the basis of] a more simplistic assumption along the lines of: Well, it had gone up in 5 or 6 of the last 7 years, so there's likely to be a big rise this year too.

MR. AXILROD. At present for demand deposits plus OCDs in 1982 we're allowing for, in annual rates again, a 41.6 percent seasonal increase. In 1976 this was 35.9 percent; in 1977, it was 39.8; in 1978, it was 43.0; in 1979, it was 43.7; we forget about 1980; in 1981, it was 42.6; and in 1982, we have 41.6. Under these various methods we could add to that 41.6 this 7 percentage points. As I say, our judgmental fellow would have added 2 points to that to make it 43.6, or the same as in 1979, which is only 2 percent at an annual rate. If we took the extreme, it would be 7 percent.

SPEAKER(?). And the one in the Bluebook forecast is which now?

MR. AXILROD. Well, it's what we've been using--the published figure.

MR. CORRIGAN. So, roughly what you're saying here, in the context of the first two weeks in January, is that we have a situation where on a not seasonally adjusted basis we have 4 weeks out of the 52 in the year that account for a multiple of what the money supply is supposed to grow in a year. Is that right?

MR. AXILROD. Yes. Well, January took care of a good part of that.

MR. CORRIGAN. That's absolutely crazy.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Steve, does your Arima [seasonal] adjustment allow for the change in the tax structure this year--that because of the change in the tax laws we shouldn't have the borrowing that formerly accompanied the corporate tax bills and so forth?

MR. AXILROD. I doubt it; it's really a time series analysis.

MR. WINN. That is going to be a big change, I think, in the way it affects--

CHAIRMAN VOLCKER. It doesn't allow for crediting of interest on NOW accounts either.

MR. FORD. Yes, as I understand it, this Arima statistical adaptation method makes no effort whatsoever to consider an institutional change, like a fundamental change in the tax law, that impacts during this particular period we're talking about. They're just attempting to take the knowledge from past cycles and apply that based on--

MR. AXILROD. Well, if there were a very large fundamental change in the tax laws or tax structure that we could see would change things, despite all our academic experts, we would do something judgmentally [to adjust it]. But so far as we can tell from the refund estimates and the tax payment estimates, we're not confronted with that.

MR. FORD. In that connection, Peter, we now have five months worth of data on the deficit and so far it is running about \$2 billion behind last year's deficit, is that right?

MR. STERNLIGHT. I think that's right.

MR. FORD. And yet all of the revisions to the forecast suggest that this fiscal year's deficits will be higher and higher while [actual results are] running behind. Obviously, with almost half the [fiscal] year gone, somebody is programming either a colossal explosion of spending or a colossal reduction of tax receipts or some combination of the two. What is your technique?

MR. STERNLIGHT. Well, I'm sort of a victim of the experts who give us those views, too. But, in fact, the fiscal expert at our Bank just went through an analysis of this and, even though the deficit is running close to or slightly behind the previous year's deficit, he's still looking for a deficit of somewhat over \$100 billion for this year.

SPEAKER(?). Over \$100 billion?

MR. STERNLIGHT. For this fiscal year it's about \$108 billion, I think. More of the tax reduction impact comes along late in the fiscal year--certainly in the after-July portion of it. And the defense build-up is a slow train to get moving, but once that spending gets on its way--

MR. FORD. If he says \$108 billion and so far we're running \$2 billion behind a \$58 billion annual rate, that would mean a \$50 billion swing in the deficit in the last 7 months of the year. It would add approximately \$7 to \$8 billion per month of extra deficit from now on to average that, is that right?

MR. STERNLIGHT. I'm not sure of that.

MR. FORD. Well, if you go from \$58 billion to \$108 billion, that's \$50 billion and there are only 7 months left to create the extra deficit, right?

MR. STERNLIGHT. Well, I did just get his estimates of the quarterly financing needs of the Treasury, which include not only the unified budget deficit but the off-budget estimates. That was going to be something like \$13 billion in the April-June quarter and about \$40 billion in the July-September quarter.

MR. FORD. \$40 billion? The end of [the year] is when it just blows--

SPEAKER(?). Well, it's partly seasonal, though.

MR. PARTEE. What about that June 30th reduction? That's worth about \$35 billion, at an annual rate, which would be \$9 billion a [quarter], or close to that. That would be a good deal of it right there.

MR. AXILROD. Thus far in the first two quarters of the fiscal year, we have \$70 billion out of our projected deficit of \$111 billion. That leaves a mere \$41 billion to go and they're not going to have a seasonal surplus. They're going to have a very small deficit in the second and third quarters of the year. And then in the fourth quarter of the fiscal year, the third quarter of the calendar year, we get the tax decrease. It's not very difficult to get up over \$100 billion.

MR. KICHLINE. The second quarter is virtually zero. It's a small negative in contrast to the usual surplus.

MR. FORD. Surplus?

MR. KICHLINE. And from a zero in the second quarter it goes to a \$39 or \$40 billion deficit in the final quarter of the fiscal year, which is when the tax cut comes along. So it's a huge swing going from the spring into the summer months. I would note also that there's a bit of confusion among many analysts on why the deficit early this year was not as large as anticipated. It is thought that part of it may be associated with the change in the tax law--namely the increase in the [penalty] interest rate, inducing people to pony up the money in January--because receipts in fact were running a good deal higher. So, apparently, it's in part associated with the change in the penalty rate for late [payments].

SPEAKER(?). It's 20 percent.

MR. KICHLINE. Right.

MR. GRAMLEY. And part of the answer may lie in the trend of the deficit in the next two years. If you look at page I-8 in the Greenbook, [your projection of] the NIA account deficit started out at \$74 billion, then \$68 billion, then \$46 billion, then \$47 billion. It was on the way down. This time it's starting to go the other way. And that can make a big difference between where we are now relative to where we were a year ago and how the annual totals add up.

MR. FORD. I was just looking for something to be hopeful about, but you're making me feel depressed.

MR. STERNLIGHT. I have had the same hope, but--

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. Could I raise a question? Thinking about Peter's recitation of the policy actions taken over the past months, and then looking back a bit over history, how do you answer the question: Has the policy caused or prevented short-run variability in monetary growth?

MR. FORD. Yes, this question came up, not just from the usual monetarists but from a variety of sources when we had a huge group of people at our Atlanta conference. A number of them, like Larry Klein, were very sympathetic to us. But it was remarkable how many--not just the standard old line monetarists--had questions about this. The way it came out from some of them was this: If you say there will be wider variations in interest rates, should you try to control the [monetary growth] path in some way to take some of the fluctuation out? Implicit in that statement is the hidden assumption that we're now successfully operating counter-cyclically in fine-tuning the economy, and they question whether that can be so. I guess the question is: Do you really feel that you're working against the swings in rates so that if we somehow had smoothed the [monetary growth] path it would have produced more violent fluctuations in interest rates than we've seen?

MR. STERNLIGHT. That would be my expectation. If we tried to hold very rigidly to a path in weekly periods, let's say, we would get even more rate fluctuation. I find it very hard to answer President Winn's question about whether our actions contribute to greater or lesser variability in money growth. I think it probably depends some on the time periods chosen. My feeling about it is that looking at periods of a couple of quarters at a time, let's say, what we're doing works in the direction of achieving the desired growth rates. Now, there could be things in our response mechanism itself that lead to some fluctuations of one or two months in character, just because we see a bulge and respond to it and that depresses growth a month or two later. There could be that kind of cycling, but that might be a minor variation around the more underlying trend we're trying to achieve.

MR. AXILROD. We do have a number of people starting to work --they have been at it for about three weeks--on very detailed analyses of the variability we've had since October '79. They are trying to isolate what we can attribute to special credit controls and NOW accounts and are trying to relate the method of operations to any elasticities in response to interest rate changes, with the aim of seeing if the method involves greater fluctuations in both necessarily or if it's an accidental product. I hope we will have some results to report.

MS. TEETERS. When do we expect to hit the debt limit now?

MR. STERNLIGHT. In June or July maybe.

SPEAKER(?). June.

MR. STERNLIGHT. June. The expectation a month or two ago had been that we might hit it in May. But they were doing a little better for a while, so I guess it has been pushed back to June.

CHAIRMAN VOLCKER. Any other questions? Well, we will expose you all to Mr. Kichline's forecast.

MR. ALTMANN. We have to ratify the actions.

CHAIRMAN VOLCKER. Yes, we have to ratify the actions.

SPEAKER(?). So moved.

SPEAKER(?). Second.

CHAIRMAN VOLCKER. Without objection. Mr. Kichline.

MR. KICHLINE. [Statement--see Appendix.]

CHAIRMAN VOLCKER. Well, let's take a little time to discuss the forecast or raise any questions about it or put forward any dissenting or agreeing views.

MR. MORRIS. I noted that the data available for March--commodity prices, initial claims for unemployment compensation, and the stock market, all of which are leading indicators--showed an increased weakness in March. That at least raises a question in my mind about whether the second quarter could be negative.

MR. KICHLINE. Oh, I think it's possible. You're quite correct that those indicators--and we have really nothing else--point to further weakness in the second quarter. The staff's forecast has about flat final sales, which is risky. All of the positive numbers we see result from a slower runoff of inventories, and forecasting inventories is currently messier than M1. So, I think there's a good deal of risk in the forecast and I would say it's primarily on the down side. The one encouraging thing is that when you add up the various sectors, we're clearly not getting the major declines in spending that we saw earlier. But at this point it seems to me it's very risky and we could have further to go before the economy, in fact, turns up.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLEs. Well, Mr. Chairman, my question was going to be much the same as Frank's. Maybe I'll still ask it. Jim, in view of the concluding statement in your presentation about the rather grim outlook for the federal deficit and what that implies for the level of interest rates, to what extent does your forecasting model--judgmentally adjusted or not--take into account how the high level of real interest rates, from which nobody can really see any near-term relief, might inhibit or even abort the recovery that we would otherwise expect to have? That's my number one worry these days.

MR. KICHLINE. Well, the one formal approach to this is using the econometric model, and for 1983 that model provides high levels of

nominal and implied real rates as well. Actually, for 1983 the model would provide a bit more real growth than we have in the forecast. I think one of the real issues is the whole time pattern of this and the maintenance of what by 1983 would be implied real rates of interest in the area of 10 percent or so, given our interest rate expectations. That situation is unlikely to persist; it will change at some point. The question is when. We don't have it changing in 1983, but I do think you're quite correct in asking: How does [economic growth] continue on this particular course? It seems that in a short-run sense what we have is a classic crowding-out situation with a good deal of stimulus provided by the federal government in terms of generating additional incomes in the private sector through the tax cuts as well as the federal purchases in the defense area. But we have very sick housing markets and durable goods markets, which are squeezed out in this process. So, it's a real structural problem. And, obviously, it's also true that forecasting interest rates is very difficult. And one can see the change there.

MR. BALLES. All right. Thank you.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. If I'm reading the numbers right, you are estimating a GNP implicit deflator for the first quarter of 5.0 percent; but for the second quarter it jumps up to 6.6 percent and then comes down again substantially in the third quarter and fourth quarter to about 5-1/2 percent. What explains such an abrupt shift in the deflator from the first to the second quarter?

MR. KICHLINE. Well, it has to do with changing weights on these things and in part it reflects developments in energy prices. In part it's also the auto sector, where we had more auto sales in the first quarter when rebates were on and we have assumed, rightly or wrongly, that the rebates go off in the second quarter, so there's a bit of a price kick from that. It's mainly the changing weights and the break in world oil prices and gasoline prices and how that feeds in. I guess I'd try and cut through all of that and say that we now very clearly seem to be on a lower inflation path, too low in terms of the underlying rate. Nevertheless, a lot of things have come along in a very positive way recently, rather than these negative shocks that we had been getting before.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Jim, as I understand it, essentially what you have in the forecast is a generalized shot of purchasing power coming from the tax cut being offset by continued very stringent conditions in financial markets and, therefore, in credit-using sectors of the economy, such as housing and plant and equipment and, to a lesser extent, consumer durable goods. I can't fault the arithmetic of that because it is a big shot that comes from the tax cut. But the effect of this is to extend, and maybe even further aggravate, the extreme frequency distribution of situations that industries find themselves in. [We have] what is generally a flat economy, with housing remaining very low, with automobile sales really still quite low, and with a considerable threat of a decline in capital spending and [that would have] an effect on those industries. It's awfully difficult to state this, but I'm wondering what the psychological impact could be

of seeing these industries and these parts of the country continue to deteriorate or at least not improve, looking on through the year. Could it have a psychological effect or something like that on capital spending or consumption that would make this forecast not work out?

MR. KICHLINE. Well, these things, as you well know, are very difficult to try to take into account. I think the inherent structural problems in the economy grow over time as we live in a world in which markets on average have been weak now since 1979. It's really a three-year sort of problem. And by the third year of high interest rates, many firms obviously have been weakened in that process. Should a surprise come along in the sense of the failure of a firm--especially a firm not on the list generally talked about but truly a surprise and a major firm--it could have severe consequences. And we have not allowed for that, obviously. There's also a question of what it means in terms of fiscal policy. I think that's rather important. There are lots of programs being talked about in terms of housing subsidies, which could alter this. But they also feed into the budget problem, and I would think the more severe the implied recession in various parts of the country, the more difficult it would be to follow through on spending cuts and tax increases. So, the fiscal side it seems to me is one that's at risk in terms of trying to get a larger deficit reduction program in place.

MR. BOEHNE. I might just add to that, Chuck. As I talk to people, I get the feeling that the mood has spread from pessimistic to uncertain. And uncertain is kind of the best shape one could be in. People are very short-term oriented. If an order comes in, they're happy, but they're not at all sure they're going to see an order come along in two or three months. And it seems to me that in this kind of environment people are much more susceptible to bad news than they are to good news. There can be five pieces of good news and one piece of bad news and they tend to zero in on that bad news. And with the high real interest rates that we have and the pressures on the balance sheets, we almost inevitably are going to get some kind of a shock--some bad news--that is going to have a pretty bearish effect on the economy. I just sense that people are skating on very thin ice.

MR. PARTEE. Well, that's along the lines of what I'm thinking. We have had a tremendous increase in business bankruptcies and they could go tremendously higher in the period to come. There are people in towns in the Midwest who have run through almost every avenue of income maintenance available to them and they're about to be dropped off, with no income to speak of, in a situation where they still have to maintain somehow those communities and families. All that gets reported very, very actively in the media, so that it can have a psychological effect on the whole country even though it might be happening mainly in Michigan, Indiana, and Ohio, and a few places like that. And I am concerned about what the--

MR. BOEHNE. If I were putting together a forecast, I'd probably be about where Jim is. Although I think there is a bottoming out, I haven't seen a lot of evidence that a recovery is occurring. But it's this thing that one can't measure--the sense of vulnerability to the economy because of the psychology--that really gives me more concern than anything.

CHAIRMAN VOLCKER. Mr. Black.

MR. BLACK. I think Chuck has raised an excellent point, Mr. Chairman, and this could change the whole situation around, but when I get at the bottom line I believe it's a question more than anything else of whether or not we can sustain and extend this recent progress that we've made on the inflation front. I think the staff is about right on the [cyclical] trough; I believe we're either there or very near it and that we have in place some key elements of good recovery in the form of the July tax cut and stepped up defense outlays. But we're going to have to have some kind of rebounding bond market and more generally an increased optimism on the part of businesses to spend on capital outlays before we're going to have any real kind of improvement. And it would deliver a lethal blow if inflation does pick up. It would be bad news for the bond markets and for the mortgage markets and in addition I think it would dilute some of the pickup that we would get from the impending tax cut. And if that's the case, then the recovery is not going to be as robust as the projection. But if we succeed in getting the kind of inflation that the staff is projecting, then I believe the recovery may be even more robust, particularly in the first part of 1983, than they are projecting. And I believe they're about right on the inflation figures.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I note that we have had a relatively rare event: namely, that the March projection seems to show an improvement both in progress on inflation and in growth. Now, that by itself is almost implausible. One would think that inflation is wound down by more slack in the economy. And here it looks as though inflation is coming down more than previously expected, while growth is a little better than previously expected; it may be the effect of oil prices, which is an exogenous element.

I would certainly agree that there's a great deal of uncertainty about any estimate now. But other than that, it seems to me that there's a considerable degree of consensus about the most likely pattern: namely, a bottoming out in the second or third quarter and then a rise. There's some disagreement about the strength of the rise, but our projection now is coming closer to that of the Administration than it used to be. So, in terms of the most probable course of events, there is a high degree of consensus. The dispersion around that consensus is something else. There is a high degree of uncertainty, but that is part of the process of winding down the inflation. If everybody were completely sure of what he expected, there would not be a great deal of pressure on wages, prices, and financial behavior; and I think we have to accept this as part of the cost of the process and part of the cost of making progress [on inflation], which really has been quite remarkable to date.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Well, Mr. Chairman, I certainly agree with the comments that have been made suggesting that while the economy may be bottoming out, it's pretty hard to find any evidence that much more than that is happening. Indeed, even that could be transitory. Several points have been made about financial strains or credit quality, call it what you will. My own sense of that phenomenon is that the degree of uneasiness associated with that certainly has

increased and perhaps sharply so, even in the framework of the last 6 or 8 weeks. For example, bankers in the Ninth Federal Reserve District, who aren't used to those kinds of things, all of a sudden are speaking very openly and candidly and with some real concern in terms of how they are now looking at the situation. At least in our area, the clear deterioration in the farm sector has something to do with that. It's always hard to make a judgment as to the underlying situation in the farm sector because farmers tend to make it sound bad even when it's good. But, certainly, both the anecdotal and the hard information that one can pull together would suggest that we are perhaps on the threshold of a very troubling situation in the agricultural sector. I'm not sure what can be done about it, perhaps nothing. The thought crossed my mind that perhaps we should dust off the seasonal borrowing program and talk about it a little as a way of maybe trying to provide a little help there. But it clearly is troublesome.

On the inflation side, I think the evidence of a slowing or moderation is getting more and more pervasive. About the only place I can't see any hard evidence of it is in some of the white collar service areas, including banking and finance.

CHAIRMAN VOLCKER. I thought for a moment you were going to say in the Federal Reserve Bank experience.

MR. CORRIGAN. I left that to you.

SPEAKER(?). What is that smile on Steve's face?

MR. CORRIGAN. The other thing that is taking on a slightly different tone is what I guess I would call a level of frustration that is associated with the interest rate situation itself. Many people look at the obvious inflation [improvement] and they look at interest rates and they see these enormous premiums. Regardless of what those premiums precisely reflect, in a sense there seems to be nothing that is going to get rid of that problem. I don't think it's something that people--at least in a major way--are blaming the Federal Reserve for. Indeed, one gets some feeling that people do recognize that at this point at least the Federal Reserve is locked in to some extent, and I think that's right. At least as I would look at it, when you question what could be done by the Federal Reserve to try to deal with that problem, the hard fact of the matter is that we have very little room to maneuver. I personally can't see how we're going to get much relief from that when we're looking at, in Mr. Kichline's case, \$160 billion deficits. Nor can I see, without taking exception with your forecast, Jim, any real possibility for any kind of sustainable growth in the economy with this fiscal situation the way it is. I'd like to think that political and other forces would be brought to bear to do something there, but I don't see that happening either. So, I come out with the sense that we are indeed between a rock and a hard place at this point.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. Well, I ought to add to what Mr. Corrigan has just said and report that with regard to the Chicago District, the situation continues to be very, very serious. There is the common perception that the economy's decline may have ended, but I'd

emphasize the words "may have." Every article one reads leads one toward this consensus view that the economy is near the bottom and heading back up. But in our area there is absolutely no tangible evidence that that has in fact occurred. Mr. Kichline has gone over the major sectors, but I must say that the automotive area is very weak, capital goods are just terrible, and in railroad equipment, for example, there have been absolutely no orders for railroad equipment in months. Virtually all of the plants are now closed and they are closed indefinitely. The heavy castings orders are down almost 70 percent in some areas.

Conditions in the agricultural sector, just to add a bit to that, are looking much more serious. There has been something of an improvement on the livestock front but on the grain side it's going to be a very bleak year. Land values are continuing to decline. Although there are not very many sales, those that do occur are at very significantly lower prices and, as a result, there is a growing problem with regard to agricultural loans. Farm credit last year went up about \$20 billion or 11-1/2 percent, and it has almost doubled in the last 5 years. Most of this increase has been taken by either the PCAs or other government agencies, who are now by far the largest lenders to the agricultural sector. And as these conditions in the area continue to deteriorate, we think the collection problems are going to mount. And that is going to raise some very interesting questions with regard to how the government is going to deal with this problem. There's likely to be very heavy pressure for a bail-out by the agencies for these different credits.

So, as we look at it, there really are no tangible signs at all that we have reached the turning point, and the mood of the general population out our way could not be grimmer. It's getting much more serious. The morale and the attitudes are at a very low level and they are still going down; and there is a concern that any recovery that we might see in the country will leave the Midwest behind. There is a growing fear that although the historical evidence would lead one to believe we are approaching the turnaround point, this time it may be different in that we are in a fundamentally different period and it is going to be much more difficult to get out of this particular recession.

CHAIRMAN VOLCKER. How much do you see those attitudes reflected in wage bargaining, let's say--whether it's union bargaining or otherwise?

MR. KEEHN. I think pretty considerably. There has been a significant change in attitude on the part of organized labor, not only regarding terms and conditions, but in their whole approach to the situation. I'm told, for example, with regard to the automotive industry, that Ford and GM renegotiations have been important financially, but much more importantly the attitude of the UAW is different now. They are much more realistic currently than they were; even 4 or 5 months ago they took a very hard attitude on plant closings. Now they come in and say: Gee, isn't there a way that we can work something out so that you don't have to close that plant?

CHAIRMAN VOLCKER. Do you hear any gossip about the Harvester negotiation? That's in process now, isn't it?

MR. KEEHN. I hear a lot of gossip. Harvester, frankly can't [mirror] the GM and Ford settlements. They've got to get more [concessions].

CHAIRMAN VOLCKER. Quite a lot more, I would think.

MR. KEEHN. They have to get a lot more. Whether they can or not I don't know, because the attitude between management and the UAW, as you know, is very poor there. I don't know of any tangible information about those discussions.

VICE CHAIRMAN SOLOMON. Talking about wage increases, I met last week with representatives of about 20 leading universities in the country and I was struck by the fact that every single one of them is going to be paying salary increases this year of 10 to 12 percent. And when I asked them why, they said it was catch-up--that the university faculties and staff had suffered over the last few years.

CHAIRMAN VOLCKER. They finally can get by with great big increases.

MR. PARTEE. Yes, they're going to have volume declines in size, I would think.

VICE CHAIRMAN SOLOMON. Their portfolios are doing so well in many cases--at least those who didn't make the wrong decisions--and I guess they're able to play a bit of catch-up.

MR. KEEHN. Well, most schools are now in the process of approving their tuition for next year and a lot are going to be up 10, 12, 14 percent. I think most schools also recognize that this is the last shot at this particular process and that because of the change in the demographics and changing inflation, they won't get away with it again.

MR. CORRIGAN. There's an element of perversity. Some schools want to raise their tuition by a whole bunch just because they think it makes them an attractive school. It's perverse but true.

That is literally true.

CHAIRMAN VOLCKER. We have to quit in a minute, but in your survey of land prices in Chicago, you survey prices of actual transactions, don't you?

MR. KEEHN. Yes. But what I'm commenting on is frankly pretty anecdotal. At our board meetings, two or three of the people who are directly involved suggest that there aren't very many sales but when there are, the prices are down very, very, substantially.

CHAIRMAN VOLCKER. Well, I guess I was wondering how it showed up in your statistics.

MR. KEEHN. We don't know what price people are referring to in terms of the base from which it has come down--whether it's a recent price or if it happens to be an individual transaction at a very high level. But I don't think there's any question that when the

transactions do occur they are at lower levels; a figure of 10 to 25 percent is one that is commonly tossed out.

CHAIRMAN VOLCKER. I hear those stories. I just wondered why it didn't show up in your figures.

MR. KEEHN. Well, I think it may be going on now and it's too soon for it to be showing up.

MS. TEETERS. Do you have an increase of the number of foreclosures on farm land?

MR. KEEHN. Yes. There are increases in delinquencies, foreclosures, and bankruptcies. But, honestly, the increases are from a very low base. So, it's not yet a broad, pervasive problem. But the actual numbers are beginning to increase.

MR. GUFFEY. Just one other comment in that respect: While there are foreclosures and there are work-out situations, there are very few sales. There are offers of land sales in our area but very few sales actually have taken place. That means that the lending institution is taking over the land or their alternative is working with the borrower one more year. So, it's very difficult for us to get a handle on how much land prices have actually dropped because there are no sales to verify it.

MR. KEEHN. There are a lot of auctions, but then [the property] is pulled back when the price comes in at a lower level than is acceptable. Therefore, the banks are beginning to back into the agricultural business.

MR. PARTEE. The banks have the bottom bid in the auction-- the take-out.

CHAIRMAN VOLCKER. The fact is that if the land price goes down 10 or 20 percent, that means it's going back all the way to where prices were 3 years ago, I guess. That's the problem you have here?

MR. KEEHN. That's an important consideration. But having said that, the banks--rightly or wrongly--lent money at 80 percent of a higher level and, therefore, they have a problem.

CHAIRMAN VOLCKER. Well, Mr. Winn, Mr. Roos, and Mr. Ford, are you going to be relatively brief?

MR. ROOS. I'll be glad to wait until tomorrow if you want.

CHAIRMAN VOLCKER. Well, if you are relatively brief, we can just dispose of this tonight; otherwise we'll wait until the morning. Are you going to be relatively brief, Mr. Winn?

MR. WINN. I'll be brief. One, I think there's too much doom and gloom here.

CHAIRMAN VOLCKER. We may quit after that!

MR. WINN. If you look at the cyclical figures, they don't look as bad to me as the early '70s cycle. While unemployment is

high, it started from a much higher level, so the decline [in employment] is really not that great. And if you look at the possibility for inventory adjustment and an inventory cycle and then factor in the tax cut at midyear, it seems to me that we have some very positive forces there.

The second comment I'd make is that [I wonder if] we really have adjusted our thinking for the changes taking place in fiscal policy. I must confess that [a deficit of] \$160 billion blows my mind as does the [potential for] crowding out. But I think we have to recognize that it's a quite different kind of deficit in the sense that previously we had the tax rebate or whatever that was called and then [the financial system] had to turn around and lend to corporations to supply the goods to take care of the [unintelligible], so there really was a double whammy in the finance market. Today we have the problem that--what was the tax savings for IBM, \$100 million? And while that shows up in the deficit, IBM is out of the market by that amount. If you look at the savings certificates and IRAs and other accounts, again there is a different impact on the market from this deficit in terms of financial demands than we had previously. It's not in the sense of \$160 billion to zero by any manner of means, but I wonder if we don't overplay the size of the problem just a bit. I'm not saying that I'm happy with the \$160 billion deficit, but in terms of its impact on markets we may not get the crowding out because we may get a change in demand. And the deficit is really financing a lot of the savings and corporate needs that otherwise would show up in the open market.

MR. FORD. I pass.

CHAIRMAN VOLCKER. I think it's perhaps appropriate that Willis Winn close this evening's affair. He's more reassuring about the economy, even more reassuring about the deficit, and then he plans to go off and leave us!

MR. BOEHNE. He has changed now that he's retiring. When he was in Philadelphia, he was the most pessimistic director we had in a quarter of a century!

CHAIRMAN VOLCKER. Well, we will be saying goodbye to Willis tomorrow. I'd like to have an executive meeting at 9:15 a.m. tomorrow, if that's okay.

[Meeting recessed]

March 30, 1996--Morning Session

CHAIRMAN VOLCKER. If I recall correctly, and I'm sure I do, we were discussing the business picture. Mr. Kichline had given us what by some lights is a fairly optimistic picture suggesting that the risk may be on the down side, and a number of people had commented on that. And Mr. Ford and Mr. Roos were about to say something. I gather for purposes of secretarial summaries that there wasn't a lot of disagreement with the staff outlook but a lot of worry. That's the way I would summarize what I learned yesterday, anyway.

MR. FORD. Well, in terms of our view of the staff outlook, we always compare the staff's forecast to a variety of external forecasts, including DRI, Townsend Greenspan, Chase Econometrics, Citibank, and so forth. I am impressed by the fact that the staff forecast for the next 2 or 3 quarters is by far the most pessimistic of any of the forecasting services. That doesn't necessarily say our staff is wrong, since the record of the forecasting services isn't that great either in terms of the ability to project where the economy is going or what inflation is going to do. But looking at our District, given work we've done with local groups, we do share some of the pessimism that has been voiced, particularly with regard to the agricultural sector. We're having a large problem in our agricultural areas as well as in our forest-related industries; and in the carpet area, we're having a near economic disaster since we produce a third of the world's carpets and they are laying off people by the thousands in that [industry] in northern Georgia. So, we now have four of our six states with more unemployment than the national average, even though we're supposed to be the Sun Belt.

CHAIRMAN VOLCKER. You produce a third of the world's carpets?

MR. FORD. Yes, that's what they say, in northern Georgia.

CHAIRMAN VOLCKER. Does that mean there's a big export business?

MR. PARTEE. Yes.

MR. FORD. And it's very depressed, just as a reflection of the trends in housing. And then we have the heavy industry over in Alabama and in Tennessee, which we're discovering is more industrialized than the rest of America. I always thought of it as a rural state until I started traveling around it. We have numerous counties throughout the States of Tennessee, Alabama, and Mississippi that have unemployment rates of around 20 percent, which you don't read about in the newspapers. So, there is a lot of pessimism in rural areas and in those specific industries, and certain aspects of agriculture and the housing-related industries are in deep trouble. On the other hand, our service industries and our high-tech industries are doing very well in Florida in an emerging Technology Belt that we have down there.

Overall, my view is that there's not a feeling of depression in our area as some of you seem to be reporting. We tend still to have some guarded [optimism]. Or rather, I like the way Ed Boehne put it. In a range from uncertainty to pessimism, our business people are

more on the uncertainty end of it. And except in the industries that really are getting clobbered, including the thrifts, the home builders, the forest industry, and farming, people are still reasonably persuaded that the economy will turn around and pick up in the next few months as this staff forecast has it. People aren't lining up to jump off buildings or bridges in our District. That would be my summary of it.

MR. ROOS. We had two very interesting experiences last week. On Wednesday, we had the chief executive officers of about fifteen of our largest St. Louis-based firms in for lunch. These are large companies which in many instances are multinational in scope. The following day we had eight of the chief labor leaders in our area in for lunch. There was an interesting similarity in their attitudes. There's no question that the industries and, of course labor in terms of unemployment, are feeling very severe recessionary pressures. On the other hand--and I was especially interested in this reaction coming from the labor side--these people recognize that this was part of the process of bringing down inflation. They felt that whoever made the monetary policy and fiscal policy decisions of a year or two ago must have known that this downtrend would occur. They see it as a temporary phenomenon. As Bill said, they anticipate a recovery. And even from the labor group there was a strong recognition, and hope really, that we will continue to look to solving the long-term fundamental problems rather than reacting to the pain of the moment. Even though these people were very outspoken in their expression of momentary pain, they were optimistic for the future. And they were very strong in their support of monetary policy as in their view being much more assured of hanging in there, if you will, than fiscal [policy]. Well, I didn't come away from those two experiences nearly as depressed as some of the others of you were yesterday.

CHAIRMAN VOLCKER. What kind of wage settlements did you feel the labor union leaders were looking toward?

MR. ROOS. I think reasonable, in terms of less-than-might-be-expected settlements. They realize that they have to be flexible under these circumstances and I think this will bode well for the effort to continue to hold down inflation. These guys at least were not bitter in their reactions, and they said that even though their rank and file membership are experiencing things that they haven't experienced for some years, they're not reacting as they might have in the '30s. They're not just saying the world is going to the dogs. I felt more of an upbeat reaction in terms of the long pull than some of the others of you who expressed yourselves yesterday. And in my own short experience on this Committee, I think we've tended to get carried away emotionally on the down side when things are gloomy.

Si mentioned yesterday, when you questioned him, what is happening to farm prices in Illinois. I remember just a few years ago we were all extremely appalled at the inflationary upward movement in farm prices. So, I think it's important that we not get carried away and over-react to what hopefully will be a temporary situation.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. Mr. Chairman, you expressed my feelings almost exactly when you said there was general support of and agreement with

the staff forecast and some worry, all the same. I'd like first to elaborate on something that President Ford said about the staff forecast in relation to outside forecasts. What he said is correct with respect to the outside forecasts we look at here, but only some distance out. The Board forecast for the second and third quarters is by and large more optimistic than the outside forecasts.

MR. FORD. Yes, it's in the fourth quarter.

MR. RICE. From the point of real growth in the third quarter, it is the most optimistic, as compared with Data Resources, Wharton, and Chase. In the third quarter only Merrill Lynch is more optimistic than the Board's forecast.

MR. FORD. Yes, I'd agree with that. It's farther out, in the fourth quarter, that they have the lowest GNP, fairly high unemployment, and low inflation. For the year they are a little more pessimistic.

MR. RICE. That's right. I'm encouraged, of course, by that aspect of our staff's forecast, which projects the recovery to begin in the second quarter with GNP increasing at a 2 percent annual rate in real terms. But I'm worried and concerned that this recovery depends pretty much on what happens to inventories. Without the anticipated reduced rate of inventory liquidation, the recovery I take it will be delayed until the third quarter. In the meantime, there's a good deal of stress and distress out there in the economy with many sectors in the economy feeling a good deal of financial pressure; pessimism was widely reported yesterday. As President Winn says, there really may be too much doom and gloom out there, but it is nevertheless there. Financial conditions have deteriorated markedly for nonfinancial corporations. As you know, the interest coverage ratios for these firms have fallen to record low levels, downgradings of debt ratings have been occurring in large numbers, the business failure rate is running at a record postwar pace, mortgage delinquencies are up, and the housing sales situation didn't look as good in February as we thought it did up until yesterday. We heard yesterday about the farming sector and the problems it was having. In these circumstances, it seems to me that it is important that the recovery not be delayed until the third quarter. While there is every reason for hoping that it will occur as projected in the staff forecast, I think everything should be done to try to encourage an early recovery. Thank you.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. Well, Mr. Chairman, I have to add my name to the list of the worriers today. I don't know that I would develop a forecast, if I had to make one, that looked any different in significant ways than the staff's. But it seems to me that as the information comes in, increasingly it's calling into question whether or not we're at the end of recession and about to see a rather significant recovery. Obviously, the staff's forecast is not a recovery of the dimensions that we've seen typically in the postwar period after a recession; but it indicates pretty good growth in the last three quarters of the year, a 3-3/4 percent annual rate. And as Frank Morris mentioned yesterday, the price figures have been quite weak. Maybe we're looking at something different now but

historically, at least, prices of industrial raw materials turn up before the rest of the economy. Initial claims are still very high. Yesterday we learned that consumer confidence in March, on the basis of the Conference Board survey, was down again. The machine tool orders figures continue to be very weak. There's just no sign of abatement at all in that area, but it's a very small part of the total economy. I would say that there's at least a 60-40 chance that we won't see growth of more than, say, one percent in the last three quarters of the year; that we'll get a bump because of a turnaround in inventory investment from deep negative to small negative or zero or small positive; that final sales will continue to erode, at least in areas like business fixed investment and maybe housing; and that we will see very, very little upturn at all.

I think we have seen a very, very substantial weakening of attitudes around the country. I just sense a different kind of attitude than I can ever recall during my period as a professional economist. Part of the reason is the concern about the budget but I think to a larger extent it is a consequence of the fact that continued monetary restraint over a very prolonged period has put the economy into a very, very weakened state. I don't think we should look at what we're seeing now as an unexpected development. We've had as much growth in nominal GNP as we had any reason to expect, given what we had provided by way of increases in the stock of money--indeed, more so because we've had downward shifts in money demand. I think we're making more progress on inflation than we had any right to expect. We're making more progress than the traditional Phillips curve type of analysis would have led us to expect. So, we're looking at a situation now which is essentially of our own making, though not entirely. And now the question is what we do about it. I think we have a very narrow line to walk. I don't think we can afford to give up the progress we've made or to endanger it. But if there is a danger now, it is that we have more restraint than we want rather than less restraint than we want. I'm very much worried about what is going to happen in these next few months.

CHAIRMAN VOLCKER. When do the leading indicators come out?

MR. KICHLINE. Today, this afternoon.

CHAIRMAN VOLCKER. They'll be a little on the down side. Mr. Solomon.

VICE CHAIRMAN SOLOMON. I'd like to ask Steve and Jim a question. How do you reconcile this relatively reasonable increase in real growth in the next three quarters compared with the previous projections with the argument that the financial markets are going to be under pressure, given such a large public sector borrowing requirement? How do you reconcile that with your interest rate projections for the rest of the year in Appendix 2 in which you show the fed funds rate declining?

MR. AXILROD. Well, some of that will be implicit in my comments. In a sense, it assumes that the buildup in liquidity in the first quarter and late last year, reflected in first-quarter average growth in M1 of around 10 percent and also a large increase in M2, is divested; it is used willingly by the public to finance an expansion in spending. If it is not and if the public really wants to hold that

liquidity--it wasn't just a temporary reaction to uncertainty which is going to be unwound--then our interest rate forecast of a very slight decline might even seem a bit optimistic, which would make the GNP forecast a bit optimistic. That's how I would respond to it. Maybe Jim--

MR. KICHLINE. No, I wouldn't [disagree].

MS. TEETERS. But, Steve, doesn't that prove that the congestion that we're anticipating is not in this calendar year but next year?

MR. AXILROD. Well, as I mentioned to the Board yesterday, I refused to put the 1983 interest rate forecast in the Bluebook this time because that's such a long way off. Attitudes might change and we could have a wholly different outlook. But our basic interest rate forecast is for high interest rates in '83 of about this dimension. And with the deficit being even larger, one might want to question again the possibility of that being associated with the type of real GNP growth we have. But the quarterly model, which is of course often wrong, would suggest growth at these interest rates also. This is somewhat different from President Solomon's question of how can we reconcile this and not have interest rates higher. But even at this higher level, the quarterly model would suggest that real growth will indeed appear to be something like what we have projected.

VICE CHAIRMAN SOLOMON. Well, what are you assuming about the budgetary deficit?

MR. AXILROD. Well, Jim may--

MR. KICHLINE. For 1983?

VICE CHAIRMAN SOLOMON. I assume all these, yes.

MR. KICHLINE. Well, it's an environment in which we have tremendous government borrowing, and the amount of funds raised in the first half of this year is fairly low. That picks up in the second half and, given this forecast, would be substantially higher in '83. Much of that is government-related. The private sector borrowing, in terms of the consumer sector and mortgage borrowing, is very low; it continues to be constrained. Durable goods expenditures are not doing very well either and that's a reflection of the high interest rate environment. So, we get all of this financing but in a fairly tense situation. Steve didn't put the interest rates in the Bluebook but we actually have a sheet with the numbers written down that I look at on occasion, and we have short-term rates drifting up in 1983. So they do rise in this forecast.

VICE CHAIRMAN SOLOMON. Not in Appendix 2, though.

MR. KICHLINE. No, in 1983.

MR. FORD. The Bluebook only shows it through the fourth quarter of 1982.

MR. KICHLINE. Right. But this forecast we think would be consistent with some further rise--an upward drift in short-term

rates--throughout the year 1983. In long rates, who knows what would happen? We do think that persistence of lower rates of inflation such as in this forecast over an extended period of time ought to bring long rates down somewhat. So, we have a small downward tilt in long rates, but higher short rates. I wouldn't want to be questioned on a specific number for rates, but it seems to me that this is a mix that produces very high nominal short-term rates of interest. And we would have that in there, with rates rising from the levels in the Bluebook.

VICE CHAIRMAN SOLOMON. The bottom line, then, is that you believe, even with real GNP rising close to 5 percent in the second half of the year on average and with this very large budgetary deficit, that we still can have a slightly declining fed funds rate for the second half of this year.

MR. AXILROD. But that assumes, with this strength in demand, that the amount of money created in November, December, January, and to a degree in February, which was just a minor drop, is used by the public--just to use a word that comes easily to mind--willingly. That is, they don't want to borrow additionally to hold that money; they don't have to be cadged out of it by even higher interest rates. That money is used by the public willingly to finance spending. And if it isn't, then I don't think this forecast is consistent with declining interest rates. I don't think this forecast is consistent with your monetary targets.

CHAIRMAN VOLCKER. If it isn't, we probably have the targets too low.

MR. AXILROD. Exactly. That's going to be the burden of this implicitly.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, my thoughts are very much along the lines of Lyle's. I'm more pessimistic short-term than the staff is, certainly. I think the second quarter is going to be negative. I have not seen any basis yet for expecting an upturn. Certainly, the numbers we have in March so far don't support the proposition that the second quarter is going to show an upturn. And it seems to me that we're going to have financial conditions that are going to mean a sluggish recovery--perhaps more sluggish than even the staff has estimated. But there is one cushioning factor in the economy that no one has talked about thus far, and that is the tremendous upsurge in defense procurement, which is really beginning to develop a momentum. That will impact the economy very unevenly. Fortunately, in New England we get about three times our proportionate share of defense contracts, so it is cushioning most of our major corporations--like Raytheon and United Technologies and so on--that are in both the defense industry and domestic industry. I asked them how they're doing and they said that their domestic business is lousy; their export business, which tends to be quite large, has been hit hard by the rise in the dollar. But the defense business is booming and their only problem in defense is getting the production out. So, that will cushion New England, California, Texas, the leading [defense contractors are in those areas]. It's not going to do much for Si's Middle West, though.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Returning to this question of credit flows, which goes a little with your question, Tony: I was interested in that, too, because here we have rising interest rates and we're talking about crowding out. So, I wondered what the figures would show on credit raised by the economy. I find that in the last three quarters--that is, since [the start of] the period of downturn--the total funds raised in the third quarter, fourth quarter, and the first quarter this year as estimated amount to only 11.8 percent of the GNP. To give you an idea, that's almost exactly the same as in the 1974-75 recession in relation to the GNP. And that compares with 16 percent in 1979, 18-1/2 percent in 1978, and 17-1/2 percent in 1977. So, it's a very much smaller flow of funds to credit users than is typical. It's typical of a deep recession and continues to be typical of a deep recession in the first quarter even though interest rates turned up. And by the way, those figures include the government. If it weren't for the government, indeed, the figures would be close to recent historical lows of only 7 percent of GNP being now represented by credit to private sectors. If you look ahead, the interesting thing is that the staff's flow of funds forecast--they have a flow of funds forecast that's consistent with their Greenbook forecast--doesn't show any improvement at all in private credit flows compared with the GNP. What happens is that the government credit flows go up because of the deficit, but the private credit flows stay around the very low 7 percent area in relation to GNP. That says to me, really, that what is being forecast is whatever interest rate is necessary to keep private credit from getting going again. And that's the crowding out hypothesis, I think. But we should not say that there's a tremendous flow of credit in these markets. As a matter of fact the flow of credit is unusually small and it will remain unusually small relative to recent years even with these large government deficits.

MR. WINN. Interesting.

CHAIRMAN VOLCKER. If that concludes the comments people want to make--. Mr. Boykin.

MR. BOYKIN. Given the conditions in the Eleventh District, I guess it'd be fair to say that the level of concern is considerably greater. In a way, one has to take this in perspective given where we were and where it looks as if we might be going. The pessimism seems to be centered primarily in the energy business where the decrease in oil prices has produced quite a bit of concern. Drilling activity has slowed. I mean by that a slowdown in the rate of increase as opposed to an absolute slowdown. Part of it--

CHAIRMAN VOLCKER. I thought it actually had turned down.

MR. BOYKIN. Not from the information we have. Part of this is attributable to what those in the industry call seasonal factors. They look for a little pickup in a couple of months, but not anything like we have had. The closing of refineries is causing quite a bit of concern. As one person in the industry said, most of those are the "tea kettle" type of operations that probably should have been closed anyway. But even some of the major refineries are cutting back on their production. There is growing concern in the commercial real estate development area. It now appears that some projects that were

announced are going to be deferred. The petrochemical industry seems to be under some pressure. The media, of course, are picking this up in our area with headlines saying that the recession has come to the Sun Belt. Layoffs that are occurring, while not significant, are receiving quite a bit of publicity and obviously are affecting opinions and attitudes. In the electronics and the semi-conductor business there have been some layoffs. Of course, we have the Braniff problem that stays in the headlines down our way. And I might also mention that with the decrease in the price of oil, the bank stocks, particularly those of our larger bank holding companies, have incurred about a one-third decrease in their price over the last six weeks, which concerns them. They think the concern of the analysts who are looking at the [exposure in] energy loans is unjustified.

On the other side, though, we've had just a little improvement in the housing area, but nothing really significant, and a little improvement in autos. I was talking on Thursday to the individual who oversees and he said the economy turned ten days ago and that the recession--

MR. BLACK. What time?

SPEAKER(?). What day of the week was that, Bob?

MR. BOYKIN. The recession ended ten days ago. He said that up until then the markets were very poor. But the markets have improved substantially and there's a lot of buying activity and lot of orders being written in the markets now. Again, I don't know whether people down our way are over-reacting in one sense because we are now finally seeing some of the effects of the slowdown. And we are more or less seeing that for the first time, which might cause a bit of an over-reaction. I think the fundamentals down our way really don't look that bad. Agriculture has already been mentioned, and we have basically the same situation in agriculture.

MS. TEETERS. Are you getting a lot of in-migration?

MR. BOYKIN. Yes, we've had a lot. We're also now beginning to get stories--the press are making a lot of it, or at least are writing about it a lot--about people who have come down to the land of milk and honey and are unable to find jobs and they are living in campers, are out of money, and don't have enough money to go back home. That's pretty isolated. But yes, we've had a lot of in-migration.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. Basically, in the Twelfth District, without going into a lot of detail and more doom and gloom, we figure the economy slipped further into a recession this month. It's not just the forest products industry. Unfortunately, it's almost all the other major industries we have, including aerospace, where commercial orders are down more than defense orders are up, electronics, nonferrous metals, etc. But, really, what I'd like to do is to come back to a question I raised with the staff yesterday and ask it once more, hoping that they are wiser than I am. I raise this in view of the fact that I have a couple of speeches scheduled this week up in the Pacific Northwest for audiences likely not to be terribly friendly

given that the unemployment rates are as high as 25 percent in some counties in Washington and Oregon mostly, but not entirely, because of the forest products industry. The \$64 dollar question, of course, is: What in the heck is keeping those interest rates up in spite of the fact that we've had great success in bringing the inflation rate down? For a couple of years now I have been more or less promising these same people that if we got the inflation rate down--bit the bullet and persisted in tight money policy--the interest rates would come down sooner or later. Well, they certainly haven't come down as yet. So, while I have my own explanation, I don't consider it terribly convincing even to myself. I'd like to hear how the staff would answer that question. What is keeping those real interest rates up there despite the fact that we've had very marked success, with more success on the horizon, in getting the inflation rate down? If you can help me, I'd be grateful.

MR. AXILROD. Well, on short-term interest rates, I think it is simply that the Committee's targets are low relative to the demand for money in the current situation. I think short-term interest rates, except for minor variations, are pretty much determined by the demand and supply for money in the very short run. On the longer-term rates, I would say that probably the world isn't yet convinced that the rate of inflation isn't going to get worse when we get out of this rather deep recession. It may not be as bad as it has been, but it may become worse certainly than it is now. Secondly, the policy of attempting to control the money supply month-by-month, which can't be done, has led to fluctuations in short-term rates because of the way the money supply behaves. [It is] out of sync with fluctuations in the business cycle and people are not convinced when rates go down that they're not going to go back up. And, therefore, there is not a great incentive, once short rates go down, to move immediately into the long-term market and capture a higher yield because one could stay short--and who knows?--the short-term rate may be back up later and one doesn't have to worry immediately about getting into long-term securities. So, I think that's another factor, which is sometimes called the liquidity premium, or risk premium. Those are my essential explanations. The thought that the rate of inflation will continue to decelerate over the long run is not firmly in the minds of investors. And they believe there's no real penalty for staying short because they're not convinced that when short rates come down they won't go back up, as has been happening cyclically, because we've been trying to control the money supply independently, in a sense, of the business cycle. And I believe the short-term rates are determined by money demand and supply under the current conditions.

MR. ROOS. Explain that to those lumberjacks!

MR. BALLE. It's like a hit over the head with a 2x4 or something!

MR. PARTEE. I think he said that you were responsible!

MS. TEETERS. What I interpret Steve as saying in a very polite way is that monetary policy is too tight for the degree of liquidity that the public demands at the present time.

MR. BALLE. And that budget policy is too loose.

VICE CHAIRMAN SOLOMON. But it's highly possible that if we ease the monetary targets, we would bring down short rates but there would be a perverse reaction in the long end of the market.

MR. AXILROD. Yes, I should have mentioned that the way I think the budget outlook enters into this is that it keeps the public convinced that inflation is not going to get better. That's how I think the budget enters into people's thinking. It's not just merely that there will be more securities to absorb, although that's a factor in the government securities market as such, but that the odds are that when we get on the up side of the cycle inflation will get worse. So, it is a strong factor.

MR. BALLE. Well, I'm sure you realize that this is one part of the country where they're just really screaming, pleading, and begging for relief on the interest rates before they have all gone down the tubes, with 40 percent of Oregon's lumber mills being closed and probably closed permanently. It's the kind of thing that led AuCoin, the Democratic congressman from Oregon on the banking committee, who is not always hostile and is sometimes friendly towards the Fed, to get behind one of the resolutions to force the Fed to do something. He is getting tremendous pressure from his constituents, and it's that kind of thing, Paul, that may lie behind--

CHAIRMAN VOLCKER. It undoubtedly is.

VICE CHAIRMAN SOLOMON. I'd like to ask Henry Wallich this question, too, as well as Steve and anyone else who wants to answer: If a perfectly indexed Treasury bond were put out today, what level of real interest would it have to bear in a competitive auction in the market?

MR. WALLICH. I would say it would be a good deal higher than I would have said a year or two ago. I would have said a year or two ago, 1 or 2 percent. Conceivably on a small issue it might even be negative because some portfolio managers would like it to diversify. But today I think there is a realization that real rates, before taxes anyway, are pretty high. So, I would say 3, 4, 5 percent, maybe.

VICE CHAIRMAN SOLOMON. Okay. But real rates are technically the difference between nominal rates and inflation expectations, not the actual rate of inflation. So, if the problem that we're running into, as Steve answered John Balles--and it's something we all know--is that long-run inflationary expectations have not come down, then in the technical sense of the term real interest rates aren't as high as they look. Yes, it may very well be that a perfectly indexed bond, which automatically takes care of inflationary expectations, still would carry only a 2 to 3 percent real interest rate because, if inflationary expectations are taken care of automatically, then why would one assume that a higher interest rate is needed today than a year ago?

CHAIRMAN VOLCKER. Do you suggest they sell one to find out?

VICE CHAIRMAN SOLOMON. No.

MR. BOEHNE. Well, one reason is that there's a rather large transfer of resources from the private sector to the public sector via

the credit markets instead of through taxation. And I think it takes a higher real interest rate to bring about that transfer.

MS. TEETERS. There also may be built into the so-called real rate now a risk premium to compensate for the extreme volatility of interest rates.

CHAIRMAN VOLCKER. Well, I don't think we're going to resolve this question, so we will go to Mr. Axilrod.

MR. AXILROD. Mr. Chairman, if the Committee will bear with me, I have a body of anti-climatic comments, I'm afraid. [Statement --see Appendix.]

CHAIRMAN VOLCKER. Well, I don't know where that all [leaves us]. The big question is with respect to M1 and we live in a kind of morass that leads one to put a certain amount of weight on M2. In looking at what has been happening in the first quarter, you said M2 is running a little high. Well, it is, I guess, compared to the base of the whole [fourth] quarter, but if you look at the last three months its behavior has been pretty orderly from what we know now. And I don't think it would require a slowdown in the growth--I haven't done the arithmetic--in its nontransactions component if you look at the last three months as compared to the quarter-to-quarter [growth]. I don't see how it could. So, we have had a big M1 growth and the monthly figures have been more or less in line for M2. If M2 were weak and M1 were high, which has not particularly, if ever, been the case, I'd say we might have an argument for looking at the long-range target at this meeting. But I don't think we have that argument and I would not propose to do so. Anybody can have their own opinion. But if things grow a certain way, it's going to have to continue to be on our agenda for the next meeting in May or the following meeting I suspect. We do have a situation, to put it bluntly, where NOW accounts are way up and the rest of demand deposits are at least being slightly squeezed. They're fairly level or down depending upon what week one looks at. And I continue to have a very large suspicion that there is some liquidity preference shift, at least temporarily, that has been going on. The whole question, when you look at the M1 figure is how long [its rapid growth] will last, as Steve suggested. Who has a comment?

MR. ROOS. I have a question, and I apologize because I will confess to an inability, Steve, to understand every word in your presentation and the significance of it. But let me just ask a couple of fundamental questions that I think have a bearing on which of these alternatives we choose. Let's assume that our primary long-run concern is inflation and our primary shorter-run concern is the effect of whatever we do on the economy. How would alternative A, alternative B, or alternative C impact output over the remainder of this year and how would they impact the longer-range inflationary situation? How would you describe the three alternatives in terms of their impact on these two results? Could you express that?

MR. AXILROD. Well, I'll try. [A policy stance] somewhere between alternative A and alternative B is consistent in the short run, we believe, with the staff economic projection. One can't be very specific there, but if the choice is somewhere between alternatives A and B, that essentially says that interest rates ought

to track down a little in the very short run. Over the long run, as you know, a recovery is projected, fueled by defense spending and the impact on consumer spending of the tax cut at midyear. At the moment, we think that could be done without any further rise in interest rates into late next year because of people having accumulated liquidity.

Alternative C says that interest rates might go up, and probably will go up, substantially; and even "B" says some rates may have a little back-tracking in them. I believe "C" is quite inconsistent with anything like the pattern of recovery [forecast] because whatever initiative might be coming in terms of housing being vaguely sustained and inventories not being a drag, I think the rise in interest rates entailed by alternative C would turn those factors less positive if not absolutely negative. Thus, we would not get an environment consistent with economic recovery not to mention the psychological impact of the greater doubts cast upon the safety and soundness of thrift institutions under the circumstances. That would be my answer. In a long-run sense, one might argue then that alternative C is most consistent with getting inflation under control.

MR. ROOS. Would "A" or "B" imply that we're going to seek to get back within our [M1] range? Would that imply relatively slow M1 growth for the last 6 months [of the year]? Let me put it differently: Would that imply M1 growth that could be so slow as to have a recessionary effect in the latter part of this year or an abortive effect on the recovery early next year? Or do you not believe that there is a relationship between--?

MR. AXILROD. Oh, yes. It depends on where [in the range] the Committee wants to hit for the year. As we tried to show in the table toward the back of the Bluebook, adoption of alternative B, for example, would be consistent with [M1] growth in the second half of the year, on a June-to-December basis, of 3-1/2 to 5 percent, depending on whether the Committee aims at the middle or the upper part of the present range, letting alone any base shifting that might be considered. Alternative A would be consistent with growth in the 2-3/4 to 4 percent range. Our assumption is that inflation rates will be down and that there will be some cyclical expansion in velocity and those growth rates might be generally consistent with a reasonable rebound. It may not be as large as we have there, but somewhere in that magnitude.

MR. ROOS. I guess I view this somewhat differently than some of you. What disturbs me, Mr. Chairman, is that it is apparent from past experience that when we have had a significant reduction in the rate of money growth--let's say, growth for 6 months below the trend rate prior to that 6-month period--inevitably it almost always resulted in a negative growth situation. That is true if you look back at [the trends in money growth that] preceded previous recessions. When we consider whether or not we would act quickly--to use the expression we've used--to "pinch off" another bulge, I think we have to look ahead and recognize that if any accommodation in policy today were to necessitate an abrupt reduction in the rate of money growth over the last half of this year in order to achieve our targets, the probability is that this would bring us back into a somewhat recessionary situation in the last quarter of this year or the first quarter of next year. And I think that is an issue that

should be considered in whatever policy decisions this Committee makes today.

MR. BLACK. Larry, are you suggesting that we pinch the April bulge off so we can let it grow faster after that?

MR. ROOS. Well, if I had to opt for something, I would say that if there is an April bulge, it should be brought down almost as quickly as possible in order to permit money to grow gradually over the last part of the year. On the other hand, that could cause a 2- or 3-week--if one can define it [that closely]--upward movement of the fed funds rate and other short-term interest rates and that does frighten some people. It's a matter, though, of whether we bite the bullet now in order to position ourselves for growth in the aggregates in the second half of the year or if we tolerate that, as we sometimes have in the past, and then are forced to keep money growing at a very low rate, as occurred for six months last year. In our analysis, that is what we did from May to October of last year, and it was a contributing factor to our present weak economy. Now, this may be seeing it from a monetarist point of view; I assume it is. And some of you may not share that view. But it worries us, looking into the future, that we may be setting the stage for problems at the end of this year and going into next year.

MR. AXILROD. Mr. Chairman, if I just might clarify one comment you made. The nontransactions component of M2 was growing very moderately in December, January, and February, after having grown rapidly in November. The latest data we have for the weeks of March suggest a very rapid growth--something like 12 percent at an annual rate in that month--and that is what brings the growth in the first three months of this year up to around 9-1/2 percent. And we believe you have to get it lower than that--not a lot lower, but maybe down to the high 8 or low 9 percent area. But it's really [due to] the behavior in March.

MR. PARTEE. That's not M2 but its nontransactions component?

MR. AXILROD. Yes, but I was just clarifying the point.

MR. BLACK. Steve, do you feel pretty comfortable about your projection of the aggregates for March at this point?

MR. AXILROD. No. We have the preliminary data [only]. That has a sharp drop of almost \$3 billion in the week of March 24, as you know. And we have assumed a rise of \$1 billion in the next week, which is a very reasonable assumption. So, in that sense, I wouldn't expect a large variation, but there will be some. I think we're in the right order of magnitude.

MR. BLACK. You think you're as close as you usually are?

MR. AXILROD. Well, I think fairly close. It could vary 2 or 3 percentage points at an annual rate.

CHAIRMAN VOLCKER. I'm somewhat uncomfortable with too precise projections of what any of these numbers may mean and of the interest rates that really may come up. The difference between "A" and "C" is \$3 billion on M1 in June. That's one week's fluctuation.

MR. AXILROD. Well, the fluctuations average out, we hope.

CHAIRMAN VOLCKER. Mr. Morris.

MR. MORRIS. Well, Mr. Chairman, I'm still having a little trouble reconciling the assumption that the adjustment to nationwide NOW accounts was completed in December with the fact that NOW accounts have been growing at about a 50 percent annual rate in the first quarter. Somehow, those two things don't come together very well for me. And the fact that most of this money bulge was in NOW accounts raised a question in my mind about whether this bulge means the same thing that a bulge in the old M1 would have meant. This leads me to a question for Steve. It's a hypothetical question, but I'll ask it anyway. If you assume that we did not move to nationwide NOW accounts last year and that the NOW accounts were still confined to New England and New York, would you have expected, on the basis of what has happened, a 10 percent rate of growth in old M1 in the first quarter? Or is that too hypothetical to even--?

MR. AXILROD. First, we don't think the shift has been completed; we think it has come down to modest proportions. Second, I assume--I guess contrary to your view, President Morris--that the increase in NOW accounts that we had is part of or the same as the related increase in savings accounts that occurred at the same time.

MR. MORRIS. But in the absence of nationwide NOW accounts, these deposits would have been in M2 but not in M1.

MR. AXILROD. That's right. And that makes the problem for the interpretation of M1. I'm not interpreting that growth of 50 percent as representing a shift from demand accounts to NOWs or a shift from old savings to NOWs but an aspect of allocating more of one's savings and possibly more of one's income to highly liquid instruments, some of which are now in M1 where they didn't used to be and others of which are in M2.

CHAIRMAN VOLCKER. It could have shifted into M1 if we didn't have NOW accounts. We never will know that it wouldn't have. It wouldn't have been a nice figure.

MR. AXILROD. There might have been some more in demand deposits, that is for sure.

MS. TEETERS. Didn't a survey of the banks indicate that there was no major increase in the number of accounts?

MR. AXILROD. Well, the increase in accounts--I don't have the number here--has been at the same rate since the beginning of the year as it was from August to November, or something like that. And that probably is a more rapid rate of the birth of accounts. It's much less than it was at the beginning of [last] year, but possibly more rapid than you would expect if there had been no shifts. I think there has probably been a residual shifting. But there would have been no acceleration in this recent period, [based on] the figures we get from the commercial banks on births of accounts.

MR. MORRIS. But it does raise a fundamental question as to whether transactions balances as we used to think of them actually bulged in the first quarter or not.

MR. AXILROD. Well, that's right. As the Chairman says, transactions accounts as we used to think of them probably would have bulged somewhat because if you get an increase in liquidity preference, some of it would have fallen into demand deposits. Also, to the extent that reflects the fact that interest rates were going down and one is going to wait until they go back up--the conventional Keynesian sort of speculative motive--that would have fallen into demand deposits. So, I think demand deposits would have been a little higher. But of course we have the old savings account vehicle in there as well, which is probably distorted.

CHAIRMAN VOLCKER. Well, what all this demonstrates is that these movements preoccupy us and they preoccupy the market. But we know very little about them except that we generally accept it as a change in liquidity preference. But we certainly can't identify that very closely. I hope some work is going on that.

MR. AXILROD. Oh, it is. Absolutely.

CHAIRMAN VOLCKER. We may be in better shape--I hope we are--by the time of the next meeting from various directions whether through surveys or otherwise to maybe find out nothing. But if we have satisfied ourselves that we tried a little harder to find out, maybe we will find out something. Mr. Guffey.

MR. GUFFEY. Thank you, Mr. Chairman. My view of what we should do in the period ahead is influenced in some measure by a point that Larry Roos made with respect to what we do in the second half of 1982. Let me start my comments by saying that from my perspective all the doom and gloom that was presented around the table shouldn't be unexpected. A year and a half or two years ago, we set upon a course through monetary policy that would bring economic growth to zero or a negative rate for some period of time and then to a very slow rate of growth thereafter. And I think we've achieved that. In a sense, we ought to be pleased with what has been accomplished up to now.

The question then arises, for me at least: What do we do in the period ahead in view of economic activity that is zero or maybe even negative for another quarter? In looking ahead, there seems to be a lot of potential for stimulus beyond what we would do at this table, with the deficit and the government spending that is in train for the third quarter of the calendar year, the last quarter of the fiscal year. That's somewhere between \$40 and \$50 billion that has to be raised in the market and will be spent. Together with the tax cut that comes on July 1, it would seem to me that there is a good deal of stimulus that will hit the economy starting in July or thereabouts and continuing on through the last of the year. So, I'm not so concerned about getting money growth at some higher level to be sure that we don't kill the goose that has laid the golden egg. Therefore, I would like to propose that we look at alternative B or something a bit less than alternative B, which is designed primarily to ensure that as we get into the last half when we get the stimulus that we will have some growth, in the 4 to 5 percent range. And with the projection for the deficit and the amount of money that must be raised by the government

in the markets, if we don't have some latitude for growth in the 4 or 5 or 6 percent range, we're going to have interest rates at very high levels. And I would hope that that would not occur. Thus, someplace between "B" and "C" for the second-quarter period would seem to be an appropriate policy response.

With regard to all the talk about the April bulge, I don't know what all that means, Steve, other than that it means uncertainty. And as a result, I am attracted by your proposal--I believe it was a proposal--that we use M2 as a direct informational variable to guide policy during the upcoming period. So, I would take a policy stance someplace between "B" and "C" for the second quarter, but give some weight to M2 as an informational guide as to what is happening in M1.

CHAIRMAN VOLCKER. Governor Partee.

MR. PARTEE. Well, I want to come back to NOW accounts. I have basically the same concern that you expressed, Paul. If you look at the behavior of the narrow aggregate as it used to be defined, it looks as if there's some squeeze on it. If you look at it with NOW accounts in it, it looks rather substantial. As a matter of fact, to put an exact point on it, if you use the old definition of M1--currency and demand deposits--you will find that in the seven months since the cyclical peak it has increased at an annual rate of only 1-1/2 percent, which is the lowest growth rate of the last four recessions.

On the other hand, if you include NOW accounts, you will find that it has increased 7 percent at an annual rate in the seven months since the cyclical peak, which is the fastest rate of the last four recessions. So the way one looks at this NOW account surge makes all the difference in the world. It may be that Frank is right. I think we probably don't have a very good handle on how many NOW accounts are being opened. And I rather despair, this far into the exercise, of finding out much really useful information on the number of new accounts. If he is right, it's not going to come out again because those are new accounts and the funds won't come out. Or it may be that Steve is right that [the bulge reflects] precautionary balances but we don't know whether those precautionary balances are going to come out or not. But the fact of the matter is that over the last several months we've had very large growth rates in the NOW account component. What they call OCDs now was still 20 percent or thereabouts in March, Steve. I think that ought to affect the way that we look at this target rate simply because we don't know what is going to happen to that component. We can't continue to squeeze what amounts to corporate balances in order to accommodate the rise of NOW accounts if they continue to rise at a very rapid rate in the period ahead.

As I look at those paths, there's nothing at all exceptional about "A." It has 4-1/2 percent growth [in M1] in the 3 months from March to June. That 4-1/2 percent growth doesn't sound like a large growth rate to me for M1 and that includes whatever disproportionate increase was occurring in NOW accounts over that time. It didn't seem large in March; it was about 2 percent. February was, of course, minus but that was an unwinding of the demand deposit explosion in January which did in fact, as you expected, totally unwind in the month of February. Therefore, my view is that we ought to be prepared

to accept modest continuing growth in M1, and 4-1/2 percent in my view is modest. And if, in fact, these NOW accounts don't come out--that is, if we don't get some correction of this very large increase that we had over the fall and winter--I don't think that will impact on the second half of the year because my view of the matter is that we ought to change our targets. We ought to accept a higher growth rate for the year as a whole, which would have been entirely because of the increase early in the year associated with this explosion in NOW accounts. That's if those balances don't come out. If they do come out, then we can make room for it. I must say I see no reason to squeeze the economy harder and harder at this point in time, given the conditions that we've been talking about and given the fact that we are looking at something that has the cosmetic oddity of an explosion in NOW accounts accounting for virtually all of the strength that we have seen.

CHAIRMAN VOLCKER. Mr. Solomon.

VICE CHAIRMAN SOLOMON. I would favor something very close to "B." It seems to me that it positions us reasonably well, given uncertainties about the reversal of velocity in circulation. I would recommend a slightly lower initial borrowing target. Instead of \$1-1/4 billion, I'd opt for something like \$1.1 billion, first of all because that's more likely to prevent the funds rate from going beyond 14 percent. And secondly, if there is a bulge in April--if M1 growth is somewhat larger than the 9 percent--we can accommodate it more easily. That would demonstrate a consistency in policy but at the same time I think it's really better to try to keep rates from exceeding 14 percent in the next couple of months if possible. So, I would not think the answer should be between "B" and "C," but pretty much "B" or in that area, with a slightly easier initial borrowing objective.

CHAIRMAN VOLCKER. Governor Wallich.

MR. WALLICH. I'm starting from the premise that we're not going to get inflation down much more unless we can sustain some degree of pressure. So, I think some degree of pressure is consistent with a moderate rate of growth. I doubt that it's consistent with the 4.5 percent rate of growth of the GNP, not money supply, that the staff has forecast for the second half. That is really quite a good growth rate, and in that environment I think concerns about excessive wage payments will yield very quickly to a feeling that now is the time to catch up--that people have made sacrifices and they need to be rewarded by compensatory higher increases. Now, a policy of about 3 percent [real GNP growth] should allow for possibly some reduction in [un]employment. It depends on productivity. I think it carries some risks that a financial crisis might hit. But as we look at the interest rate projections of the staff, they don't seem to indicate that the problem of the thrifts will be greatly alleviated no matter what we do. There's the danger also that the dollar may go higher. If we do damage to our exports, we may do damage to other countries that reflects back on us. I think that danger is less because they are now beginning to realize that a high dollar is not so much of a risk for them and that they can afford to reduce their interest rates. Now if one accepts, as I do, aiming at something like 3 percent real growth, then I think alternative A really lacks credibility. It lacks credibility, anyway, in terms of our [long-run] targets because it

means that we're going to be above our targets for the rest of the year. And we're going to have that held against us continually.

CHAIRMAN VOLCKER. Targets? It doesn't say [that] about M2.

MR. WALLICH. Target. [M1] would nevertheless be the key target that people will look at. We will look at the M2 increasingly; I agree that we want to put greater weight on M2 partly because of the uncertainty surrounding M1. If one thinks that the growth of M1 is very low, one might conceptually add some of the money market mutual funds to it--10 percent or 20 percent of which surely are transactions balances--and that would produce a much better growth rate in M1. Now, there is a danger of making the same mistake Mrs. Thatcher did: that is, chasing an aggregate that is actually positively interest rate sensitive. The harder you lean, the harder it blows; as sterling M3 grows, the more they tighten. There is some danger, I think, in our situation of falling for that with M1. So, I would put somewhat less emphasis on M1, but I wouldn't ignore it.

MR. PARTEE. Do you mean M1 or M2?

MR. WALLICH. M1, because M1 contains a saving component.

MR. PARTEE. But M2 contains all these things.

MR. WALLICH. Well, it may have the same defect. Either way, it would lead me to somewhere between "B" and "C." And I would not like to see interest rates go up at this point, so I would hesitate to go with a rise in borrowing. But something like the present level of borrowing would seem to me appropriate and would move us toward getting back into our target ranges over the year.

CHAIRMAN VOLCKER. Mr. Winn.

MR. WINN. My concern is the reported understatement of M1 in terms of our money funds, the sweep accounts, and all these other phenomena. If that were constant, I wouldn't be so concerned; but I think it's a growing proportion, so we may be getting more growth there than we recognize. With that in mind, I'm a little sympathetic to the problem of getting beyond April and what we do from there. I would associate myself with the comments being made with respect to "B" leaning a little toward "C."

CHAIRMAN VOLCKER. Well, we'll have Mr. Ford, and then we'll have breakfast.

MR. FORD. I come out for the "B" solution that a number of people have expressed. We also have gone through this exercise that was just mentioned of making some allowance for a small fraction of the money market funds being transaction oriented and other adjustments like that. And it seems to indicate, if you give any credence at all to that, that we are pumping in enough money to keep the economy going. I hope the staff is right with all the Arima stuff that if and when we see this pop in the numbers early in April it will be corrected before we get back here at the end of May. Well, I don't know if you said May and June. Did I hear you right that you would anticipate if we did get a big problem in early April that it would be [unwound]?

MR. AXILROD. It looks as if under all the alternatives that 6/10ths of it comes out in May and, depending on which of the alternatives you pick, either all [the rest] comes out in June or takes a little longer.

CHAIRMAN VOLCKER. Unfortunately, when we get back here in May, I think we'll just have the April figures, basically.

MR. FORD. That's right; so we won't know. The timing is bad. I certainly hope you guys are right about that coming down. In the meantime, I would be willing to take the risk of going as high as "B" or just a little below "B" in the hope that you're right even though we are going to be in a very uneasy position the next time we meet since we may have seen the high numbers you are worried about without having time to have seen whether or not it tails off. I think some caution is in order and, therefore, I'd avoid going toward "A" so that, with this neat little table you've cooked up on the bottom of page 10 [of the Bluebook], we leave ourselves some room to breathe in case you're wrong about that. That's why I'd say "B" would be a good place to be, with a borrowing assumption somewhere near where we are now, around \$1.4 or maybe \$1.3 billion; you suggested \$1-1/4 billion. In sum, I believe alternative B and somewhere in the \$1-1/4 to \$1.4 billion area [on the borrowing assumption] would be reasonable.

CHAIRMAN VOLCKER. What was that last comment you made?

MR. FORD. I'd go with the borrowing assumption associated with "B" rather than lightening up on it as Tony suggested. The staff suggested \$1-1/4 billion, as I read the Bluebook, and currently I'm told it is at \$1.4 billion. Is that right?

MR. STERNLIGHT. Borrowing of \$1.4 billion is implicit in this week's objective.

MR. FORD. The objective, yes. So, I'd stay somewhere around what is in alternative B rather than lightening up on the borrowing. That's because, if we're worried about a big explosion in early April and if that were accompanied by an explosion of borrowing, I'd say we ought to hustle back toward the path.

CHAIRMAN VOLCKER. Why don't have a coffee break. Preston Martin has been confirmed by the Senate this morning, and may even have a signed commission. We'll go out and see where he is.

[Coffee break]

CHAIRMAN VOLCKER. [We're in] a delicate stage here. Preston Martin, whom I introduced to all of you who have not known him--you can talk to him after the meeting--has been confirmed by the Senate. He has a commission signed. He is not sworn in, so he doesn't have to vote but we thought he could observe this strange [unintelligible]. I told him we are in midstream. I guess we will swear him in tomorrow. We are halfway through people expressing their opinions in varying degrees of precision about what we should do in a very imprecise art. Mr. Black.

MR. BLACK. Mr. Chairman, given the market fears that the deficit and the recession might push us off the target paths, I think

it would be a mistake to let M1 stay above the upper limit for any extended period of time. If such a result were to occur, I think it would reignite inflationary expectations and maybe even more importantly it would weaken long-term markets, which I believe would be a pretty disastrous thing to have happen at this particular point. So, I think it's very important that we react promptly to any out-sized bulge in the money supply in April. January's bulge hasn't washed out completely, and if we are not perceived as reacting pretty promptly to a bulge in April, then doubts about our anti-inflationary resolve will increase. So, I would prefer "C;" I could go somewhat toward "B" if there's an understanding that we're going to react pretty promptly against any large sized bulge in April that is greater than the short-term figures that we're looking at. And I think it would be desirable to widen the federal funds range; I would suggest 12 to 18 percent.

CHAIRMAN VOLCKER. Governor Gramley.

MR. GRAMLEY. Mr. Chairman, I expressed earlier, in my comments about where the economy is going, the doubts that I have in mind as to the prospect for a recovery of the dimensions the staff is forecasting. I would say again that I think the state of the economy is principally the consequence of monetary restraint--principally our responsibility, not that of anybody else--although I would acknowledge that fears of the deficit are contributing to the mood around the country. It's also our responsibility in the sense that we permitted a rather substantial increase in interest rates right in the middle of a very deep and deepening recession. I'm very much impressed with the line of argument that Chuck has developed. We really have something very, very unusual going on in the growth of M1 as it's currently measured. To put his point a different way: It is true that one could explain small or even moderate sized differences in growth rates of the various elements of M1 on the basis of differences in income and interest rate elasticities. But there's no way in the world that one can explain the kind of divergences that we have seen between coin and currency, demand deposits, and OCDs except by reference to something very, very unusual happening to the demand for OCDs. And we don't know what it is. It may be a continuing shift into OCDs because the process that began last year has not yet been completed. It may be a liquidity preference kind of development. We just don't know what it is.

CHAIRMAN VOLCKER. If I may interject. There's just one factor here that hasn't been mentioned, which I want to mention for the sake of completeness. I think it's probably largely liquidity preference. Part of it may just be a plain bad seasonal. We may not know how to seasonally adjust the OCDs. And maybe the distribution is really different than we think it is.

MR. GRAMLEY. I think the growth of M1 since last October greatly overstated the extent to which monetary policy has been stimulating the economy. Another factor that convinces me that this is the case is looking at the prospective growth rates, fourth quarter-to-first quarter, of the various monetary aggregates. Although less disparate and less unusual than the fourth quarter-to-February numbers, they still show a progressive decline in the growth rate as you get to the broader aggregates: 10.3 percent for M1, 9.6 percent for M2, and 8.6 percent for M3.

I don't think any alternative more restrictive than "A" is at all suitable. I think we ought to permit the economy to have the kind of growth in narrow money balances and broader money balances that is needed for some recovery in economic activity. I'd remind you, in looking at alternatives B and C, that the M2 figures in B and C are 7-1/2 and 6-3/4 percent, [respectively]. And our experience in the past several years suggests as a first rough approximation that we are going to get an increase in nominal GNP that is approximately in proportion to the growth of M2. The velocity of M2 has not been very variable recently. And over the last three quarters of this year what our staff is projecting is not a 7-1/2 or 6-3/4 percent increase in nominal GNP, but a 9.4 percent increase, or somewhere around 9-1/2 percent. So, I think alternative A is where we ought to go. And I think we ought to be very, very careful about trying to run too fast to offset a bulge in April which may reflect nothing more than the fact that we've changed our process of seasonal adjustment.

CHAIRMAN VOLCKER. What nominal GNP growth do you have for the year?

MR. GRAMLEY. Now, I was speaking of the last three quarters.

MR. KICHLINE. Fourth quarter-to-fourth quarter is about 7-1/4 percent. The first quarter is zero.

CHAIRMAN VOLCKER. What is it on an annual average basis?

MR. KICHLINE. 6-1/4 percent.

MR. ROOS. Mr. Chairman, I'd just ask one question, because I'm lost on this argument concerning the effect of NOW accounts. NOW accounts are a part of M1, are they not? And if they are, that money is usable by the banks. It's a different name for a different type of transaction balance. But why does that distort M1 growth if a certain amount of M1 growth is a reflection of growing NOW accounts? I lost that. If we are trying to figure total M1 as it is and are trying to quantify it in terms of the effect of its growth on the economy, and part of that M1 is reflective of NOW account growth, why does that distort the usefulness of M1 as an aggregate?

MR. PARTEE. It's a mixed account, Larry. It has elements of a savings account in it, too.

MR. ROOS. Yes, but that money is there in the bank and--

MR. PARTEE. Well, the money would have been there before but it would have been in savings accounts.

MR. MORRIS. Another answer to Larry's question is that the present growth ranges for M1 are fundamentally based on the old M1. That is, we wanted to show a progressively shrinking number. Now the fact is that this new M1 is a different animal from the old M1. We are applying the old M1 yardstick to something that is different from the old M1. And that's the source of the problem.

MR. ROOS. So, you are saying that our original targets were set differently than they would have been had we known that M1 was

going to be expanded by the advent of these NOW accounts? I think that's a--

MR. MORRIS. Yes.

MR. WALLICH. M1 could also be influenced by other things that change velocity. We've been more often deceived by underestimating velocity gains than overestimating them. And right now we see ahead of us two sources of velocity gain. One is the continued money fund expansion; the other is sweeps. We can't be sure we'll get that velocity, but I think it's less dangerous to bet on that than to bet on the opposite.

CHAIRMAN VOLCKER. Mr. Corrigan.

MR. CORRIGAN. Well, Mr. Chairman, as to the comments that have been made, ranging from chasing aggregates to the NOW account analysis, and did we have a bulge or didn't we: What does it mean? The comments about leaving some room in the second half of the year I think are all relevant. And in the context of this potential April bulge problem, they take on a special significance. But I think they also relate in a fundamental way to an analytic problem that I don't think we have quite dealt with yet. The manifestation of that analytic problem is the simultaneous phenomenon of a lot of interest rate variability and a lot of money supply variability. We sit here, of course, and make judgments about reserve paths and we make judgments about changing those reserve paths. But implicit in both setting the paths and changing the paths is this notion that it is ultimately changes in interest rates that are the trigger variable that sets in place the adjustments in portfolios that in turn ultimately reflect themselves in altered rates of growth of the money supply. Now, that's all well and good. But I think we have to keep some perspective on that. The perspective that I think is important is the recognition that those interest rate changes are only one of the factors that determine the nature and pace of the portfolio adjustments that ultimately do reflect themselves in the rate of growth of the money supply. In the context that we are operating now, it seems to me almost self-evident that the nature of those adjustments in response to any pattern of interest rate change has in itself changed. Indeed to take the extreme--and this is relevant in the context of this April bulge--if we are going to smooth out all those bulges and all those short-run blips in the money supply, we must be prepared to get to the point where the interest rate impact that we can create by changing reserve paths is large enough to outweigh all those other factors, ranging from seasonal adjustment factors on up. Now, as it may impact on the observed behavior of the money supply in the short run, we must be prepared at the extreme to do that in a context in which, at least in my mind, the jury is out as to what the nature of the interest elasticity of money demand is. Indeed, I still find myself, at times at least, attracted to the argument that in some sense we may be creating some of the variability that we have seen in both money and interest rates by the nature of our own activities. I'm not persuaded of that, but at least I have to leave my mind open to it.

In that analytical setting, I must say I would be a little troubled with the prospect of aggressively chasing a bulge in the money supply in April, even though that would prolong the amount of

time that we might be over the stated targets for the behavior of M1 for this year. Again, from an analytical point of view, I think Mr. Axilrod's earlier comments are relevant here. If that were to happen, it does in some sense aggravate the problem. But at the same time, if some of the speculation around the table about this NOW account phenomenon is accurate, one could still reasonably expect that the NOW account build-up would wind down later in the year and still would leave plenty of room for the kind of expansion in the economy that is implicit in the staff's forecast. The long and the short of it from my point of view would be at this time to go slow indeed in terms of this April bulge, should it materialize. I hope it doesn't because if it doesn't, we're obviously in pretty good shape in any event. As to specifics, I would come out somewhere between "A" and "B." And if we got a bulge, and the net result were that we ended up with a quarter that looked like "A," that wouldn't bother me all that much either.

CHAIRMAN VOLCKER. Governor Teeters.

MS. TEETERS. I'm basically impressed by the fact that all of our worst fears have been realized. We have nearly 9 percent unemployment. For every Federal Reserve District, the opening sentence in the Redbook was about depression or not functioning well or no sign of recovery. We have the thrifts going down. We have a liquidity crisis in the thrift industry in at least half of the Districts. We have a massive reduction in credit ratings, as Emmett mentioned, and a very high level of business failures. What more do you want? We have the economy essentially out flat. And under any of these alternatives we don't get a great deal of recovery. At the end of the [projection period] we get to maybe 75 percent capacity utilization and still have well over 8 percent unemployment. As I thought through it, so many of our other problems would be alleviated if we just had some reduction in interest rates at this point. It wouldn't help all the thrifts, but it would certainly help some. And going along with a 13-1/2 percent or 13-1/4 percent interest rate, [with rates] rising sharply next year, is not my idea of how to put this economy back to work.

Given the alternatives that we have and the wide division of preferences here, I obviously want to associate myself with Governor Partee and Governor Gramley and go for alternative A. And if it turns out that that's not doing the job of recovery then, as I said last time, we should raise our targets. We can do it a number of different ways. The one modification I would make on "A" is that I would go for a billion dollars of borrowing rather than \$750 million because I think the \$750 million is too strong a signal that we are going for ease. But I don't think 13 percent is an acceptable level of interest rates for this stage of the [cycle]. I think we can do more. I have some reluctance to ease sharply because I don't think we are going to get the correction in the federal deficit that we need to offset the collision course that I anticipate next year if the deficit is not changed. But, under normal circumstances and with a normal fiscal policy, we should be a lot easier than we are now. And the fact that fiscal policy is so overly expansionary is the only thing that keeps me from urging an even greater relaxation in monetary policy.

CHAIRMAN VOLCKER. Mr. Boehne.

MR. BOEHNE. There was a good bit of talk earlier about jeopardizing the gains that our policy has brought so far, but the other side of that is that we also must avoid becoming prisoners of our own mechanical procedures. And I think the questions that Chuck and Frank and others have raised about NOW accounts underscore that fact. We don't really have a good handle on M1 and whether we're excessively tight or excessively easy. So, I think we ought not be fearful about superimposing our judgments on these procedures. I would start out with alternative B, but I would accept errors in the direction of alternative A. I would find erring on the side of "C" not to be acceptable. I would put an M2 sentence in the directive and use it primarily as an informational variable. I think we ought to give more weight to M2 in this period. But my main point is that we ought to remain more flexible than usual in this period by weighing the incoming information on the economy, the size of the [M1] bulge, if any, and interest rates and so on, and not become overly wedded to a set of policy specifications that we agree to today and that may require more frequent consultations than usual.

CHAIRMAN VOLCKER. Mr. Keehn.

MR. KEEHN. I will admit to a significant bias caused by the circumstances in the Middle Western District. And though I certainly don't disagree in any way with the fundamentals of the staff economic forecast, I am skeptical or merely unconvinced with regard to the timing as well as the strength of the recovery. Also, it seems to me that an awful lot of uncertainty about the composition of M1 and M2 has been expressed around the table. Meanwhile, we have an economy that is operating under the very most difficult circumstances possible. While I'm not in any way suggesting a major change in what we are doing or how we are doing it, I do think that we have to provide at least a modest degree of relief, and it seems to me that alternative A is a way of doing that. I would be very strongly in favor of alternative A as a way of trying to accommodate a possible bulge that could occur in April, but particularly because M2 is in a reasonable position within its range. So, I would very much be in favor of alternative A.

CHAIRMAN VOLCKER. Mr. Balles.

MR. BALLE. Well, Mr. Chairman, as I listen to this dialogue and debate, one thing seems to stand out loud and clear as far as many of us are concerned. And I think Frank expressed it and others followed: That the observed money supply has really overstated the effective money supply, given the fact that so much of the growth since November has come in NOW accounts and in OCDs. Therefore, I would join those who would not be in too much of a hurry to lean against that kind of bulge. In responding to the tactical question that Steve posed to the Committee of how long we can continue to let M1 run above its range for the year, if this bulge had come in regular demand deposits, I'd be on the other side of the fence. But since it didn't and since the April bulge will be equally mysterious for a while, I would not be in any hurry to lean too hard against it until we have more solid information as to what we're really doing. I expressed myself pretty forcefully earlier on about the urgency of getting real interest rates down. We can't do much about long rates. That is going to have to be a solution that depends on some major efforts to get the budget deficit down. But I think we can do

something in the short run about short-term interest rates. And I'm really quite concerned that in the immediate future, unless these short rates come down, we are going to be inhibiting seriously if not aborting a prospective recovery. Where all this nets out is that I would lean somewhere between "A" and "B" in terms of what we ought to be doing in the March-to-June period. And as others have suggested, I'd place more emphasis on M2 in view of the low visibility that we are going to have on the meaning of the M1 figures, particularly as we move into April. As I say, I'd not be in too much of a hurry to get back within that range until we get better information on what the true effective money supply is, based on its changing behavior [and] content.

CHAIRMAN VOLCKER. Governor Rice.

MR. RICE. Well, Mr. Chairman, Governor Partee stated the case for alternative A very well, I thought. I don't have anything really to add to that. I would just like to remind everyone of what I thought I heard Mr. Axilrod say and that is that alternatives C and B assume that the NOW accounts or precautionary balances or whatever you want to call them are going to work themselves out very soon. And if they don't, there is the likely implied risk of their being an obstacle to the recovery. I don't think we ought to take that risk. We don't need to take that risk and I think we'd leave ourselves in a position to be more flexible if we adopt alternative A.

CHAIRMAN VOLCKER. Mr. Roos.

MR. ROOS. Mr. Chairman, as I stated prior to the recess, the decisions we make today have to be made in the context of what they will mean for our policy in the second half of the year. In looking at this, I don't think we can take lightly the targets that we have announced. I don't think we can assume glibly that we can arbitrarily adjust those targets upward when we make our July adjustment without risking a perception by market participants that our action was paving the way toward further inflation. And if we made an upward adjustment in order to bring relief to the economy, I would assume that it would have exactly the opposite effect from what its proponents might be seeking; an upward adjustment in our annual ranges would probably bring an upward movement in interest rates rather than any reduction in interest rates.

So, I would opt for something like alternative B because I think it would position us probably as well as we could anticipate under our present difficult circumstances. But I feel just as strongly as anyone could feel that if we temporize, that if we do have an April bulge and if we say we don't want to be mechanistic [in responding to it] or however we phrase it, we are going to get ourselves in a position where we are going to have to live with unacceptably fast growth of M1 in the first part of the year. If we look at it from day to day and from week to week, and if by doing so, as we have occasionally in the past, we validate that increase and don't take action to pinch it out and pinch it out awfully quickly, I think we are going to have to jam on the brakes in the second half of the year. And that is going to bring us a negative reaction in terms of economic activity later this year or early next year and we will be accused of having precipitated another recession. Regardless of how we want to view it and explain it--and nobody is more skillful

than you are, Mr. Chairman, in explaining the confusion that arises out of NOW accounts or sweep accounts or financial innovations--the people out there who set these interest rates have their eye on M1. You can't fool them into saying, well, M1 has performed this way and M2 has performed that way. That is what runs this locomotive and I think we have to recognize those things. And that's why I would disagree with those who say that we shouldn't respond quickly if this bulge occurs. I think it is incumbent upon us to react very quickly.

CHAIRMAN VOLCKER. Governor Partee has an additional comment.

MR. PARTEE. Well, yes. Larry, I don't regard that target for this year as set in stone. I think there are circumstances under which we would be prepared to shift the target. What I said was that if the NOW account dominance continues and we find ourselves, let's say when we next meet, looking at a sustained 30 percent rate of increase in NOW accounts or something like that, I think then would be the time to consider whether or not to make an adjustment in the targets for the year, based on an unexpected strength in NOW accounts --not in M1 generally, but in the NOW account performance--because of some kind of precautionary development. Now, I'm inclined to think that [the bulge] is going to come out. I can't understand why people would keep so much money in their NOW accounts at 5 percent interest when they can get substantially more in almost any alternative they could go into. Or, Paul may be right; the seasonal may be bad, but that would bring it out too. That is, if the seasonal has been wrong in the first part of the year, by definition it will be wrong later on and we'll see a weakness in NOW accounts. Or it could be that the sweep accounts will develop so that we'll get an observed slowing in M1 because sweeps are taking money out of the accounts. I don't want to prejudge at this point but I'd just say that if in fact NOW accounts continue to perform as they have so far this year I, for one, certainly would be prepared to change the targets. And I think the Chairman could very readily state why we changed the targets. It would not be because we eased but because of this unexpected development with regard to NOW accounts. We have to have that kind of freedom or we're slavishly stuck with numbers whose contents we don't know.

One other comment I would like to make is that I rather agree with the thought that we ought to use M2 more as an information device. But I'm still very concerned that I don't have a good handle on what information M2 is giving us. It looks as if we are going to have to pay more attention to M2 in the period ahead than in the period past, and I would like to have the staff begin to develop a rationale, which so far is totally lacking, for using an M2 guide. [We need information on] what kind of cyclical attributes or interest rates or elasticity attributes M2 would have. I think we need that before we can really rely on it, because we don't know what the behavior of that number [means] in the short run.

MR. ROOS. There have been studies and recent studies made--not that our studies are necessarily all inclusive or all conclusive--that show that M2 is a much inferior predictor of economic activity than M1 and that we can't control it.

MR. PARTEE. Well, of course, there are people who maintain just the opposite: that M2 is a better predictor. I think the last

study I was associated with showed that we got very little additional information when we added the M2 components to M1. And I don't know that that has changed much. But M1 is deteriorating, I think, and it may be that we'll have to have a rationale for using M2. There's no reason that can't be developed. After all, until he found that he didn't have so much to hit the Federal Reserve over the head with, Milton Friedman was for M2; it's only recently that he has changed to M1.

MS. TEETERS. Could I ask Steve to repeat his proposal on how we might use M2? I don't think I understood it.

MR. AXILROD. Well, what I was suggesting was that if M1 were running strong relative to this 8 to 10 percent that we think makes a rough allowance for the possibly peculiar behavior of April, the Committee might consider in effect adjusting the reserve paths when that is happening if M2 is not running strong--if it were running right around the top of its range or something close to where it is now. On the other hand, I also thought that because of the uncertainties in April, if M1 were running weak, it might simply mean that we did make a good seasonal adjustment; and you may not want to react to that. Then, too, you could take into account the behavior of M2 and, if M2 were also running weak, it might mean that the money supply as a whole could be considered to be running weak relative to your basic objectives. I'm suggesting using M2 as kind of a fly wheel to help judge the behavior of the whole group of aggregates, given the uncertainty about M1 in April and May.

MS. TEETERS. As I read the first quarter, we had a tremendous increase in M1 but the associated increase in M2 was not all that strong. Is that correct?

MR. AXILROD. Well, it was a pretty good growth. I may be off slightly in my number, but it's something like 9-1/2 percent on a quarterly average basis.

CHAIRMAN VOLCKER. That's a little high on a quarterly average basis. If you look at it on a December-to-March basis, it's just about at the top of the range.

MR. AXILROD. It would be 9 percent from December to March; it's running right at the top of the range.

CHAIRMAN VOLCKER. We haven't heard from Mr. Boykin and Mr. Morris in terms of specifics.

MR. BOYKIN. Well, Mr. Chairman, I would favor alternative B. Given the uncertainties and what we don't know about April and what we don't know about the NOW accounts and many other things, alternative B would seem to me to represent a prudent course that would at least position us to address the situation as it becomes clarified without an abrupt change in direction. With respect to the conversation about a change in the ranges, it seems to me that any change should be a very forthright decision as opposed to a de facto working in that direction, which I think alternative A might do. So, at this point in time at least, alternative B seems to me the prudent place to be.

MR. MORRIS. Well, Mr. Chairman, there was a time when we had another man named Martin on this Committee.

MR. MARTIN. A much better tennis player!

MR. MORRIS. He used to talk about leaning against the wind. If you want to know which way the wind is blowing right now, the wind is clearly blowing the economy down. Therefore, we ought to have a policy which is conducive to a turnaround in the economy, even if we only get a sluggish upturn as I expect. So, for all the other reasons that Lyle gave, I would support alternative A.

CHAIRMAN VOLCKER. I thought you were against a leaning in the wind policy.

MR. MORRIS. I used to be.

CHAIRMAN VOLCKER. It depends upon how strong the winds are blowing. I guess we've been through everybody with a little variety of opinion.

MR. PARTEE. Except for you.

CHAIRMAN VOLCKER. Members of the Committee are nicely split and nonmembers of the Committee are nicely split. We have an odd number of nonmembers, so they're not quite split evenly; there is a small majority.

Let me say just, in terms of changing the targets and how temporary this NOW account phenomenon is and whether it's partly seasonal, that I have a little suspicion that we're not going to know by the next meeting, unfortunately. My suspicion is that if it is partly seasonal, we ought to begin learning about it rapidly after April. That's because it may be partly a tax phenomenon: Individuals build up their balances--and they always did, we just didn't know it before--as we move into April. But the timing of the next meeting is going to give us maybe one week's clue to that, I guess, the way it works out. We are not going to have much of a track record, but we will have to live with that.

MR. PARTEE. Well, we wouldn't have to [change the ranges] in fact until the July meeting.

CHAIRMAN VOLCKER. Well, it depends. We can [change the ranges] any time. But by July we certainly ought to have a handle on that. We may not know all the answers; we may not know why; but we will have more suspicions and we will have some results of whatever analytic or survey work we do.

Just in terms of the economy, I share the view that was going around earlier. The staff has [projected] a pretty good recovery, considering the circumstances and considering that we don't want to lose the progress on inflation. But there are a lot of doubts that tend to register on the low side rather than on the high side. If we got that much, I wouldn't be unhappy. I don't think we are in a position where it would be wise to try to manipulate interest rates overtly downward. I'd love to see them come down and stay down. I

wouldn't love to see them come down for a month and then have to go up again. That would kill us for a variety of reasons, I think.

Anyhow, we have this great variety of opinion. I think what is of operational significance before we meet again is largely going to be how to handle this April situation. We don't know in which direction it's going to go. We have a great split in opinion on the Committee. I must say I reconcile that in my mind very nicely, but I don't know whether the rest of you do. Given all the problems we have, I think it may make more sense in the short run--or even in the long-run period given the doubts about what M1 means in some cases--in effect to watch pretty closely what is happening to M2. For M2 over the course of the year as a whole we've been anticipating growth of something between 8 and 9 percent; I suppose slightly below 8 percent is the staff's forecast for the year as a whole. Nobody knows for sure whether it's reasonable analytically or not, but with the kind of nominal GNP that results from a quite reasonable economic forecast I don't think it's a bad forecast in terms of our objectives and where we want to go. And M2 in the 8 to 9 percent area seems to be [viable] against recent experience. Maybe recent experience is no good, but in the last 3 years M2 has been within 1 percent of that and we have never had a decrease in velocity of more than 1 percent. And if it came out in the 8 or 9 percent area, it would seem to allow enough for this forecast, if nothing else went wrong. Given all the uncertainties in M1, and given the doubts in the economy, I would not feel comfortable about tightening up in effect to chase too hard at an April M1 figure if M2 is also running low. I don't know whether that's going to be the case; I have no reason to believe that it will be the case, but I would feel very uncomfortable about "tightening," in the common parlance, with a low M2 figure at the same time. So, I come out close to the A alternative so far as M2 is concerned. Let's say around 8 percent. I'm not sure I'd want to push on M1; it's very doubtful where it's going to go, but I don't know that we have to set out for a 4-1/2 percent M1 figure. I don't even know what it means in the context of dealing with it before the next meeting if we are going to allow for more [growth] than that in April because we will come back by the time we know April and then re-decide on the basis of what we know about April. But the more orderly thing for M1 somehow does seem to me to be something like "B," which on the face of it brings us back about where we want to be, if you take the numbers literally. By June or July it follows what the midpoint of the range would have been if we had started from the base of last year's target rather than from where we did start. It doesn't say we can't raise it if all the analysis shows [the need for] that. But I feel a little more comfortable with something on the lower side for M1, particularly if M1 produces a little miracle for us and comes out lower than we now expect in April and early May.

MR. PARTEE. Well, as you say, as a practical matter, it's almost entirely where we set April. "B" has April at 9.1 percent and "A" has it at 9.9 percent. I don't care whether it is put at 9 or--

CHAIRMAN VOLCKER. I don't know whether either of those is right. It seems a little strange, putting all our money on somebody's judgmental correction of a seasonal adjustment which is doubtful. It is piling doubts on doubts. But I think we have to reach some judgment as to how we want to accommodate or not accommodate, how rapidly we respond to an increase, and where we set the borrowing in

the first place. If we set the path consistent with a lower level of borrowing than we now have, which is what--\$1-1/4 billion roughly?

MR. AXILROD. The current week's path implies \$1.4 billion in borrowing.

MR. STERNLIGHT. The last several weeks would average more like \$1-1/4 billion.

CHAIRMAN VOLCKER. Well, let me finish. If we [set the borrowing level] below that, theoretically we produce a little easing. If the April bulge is [large] enough, we might have to respond to some degree; it would give us a little more room for responding without being any higher than we would have been in the first place. I don't know whether that is a good idea or a bad idea. But I can imagine that in a difficult circumstance it might give us a little leeway without sending things through the roof. If we have to respond to some degree, maybe it does make some sense to start out at \$1.1 or \$1.2 billion or something in that area. I guess that's what I would propose and we'll see what happens. I'd leave the federal funds rate range where it is. I'm not sure at this time that I would want to announce a higher fed funds rate range. If anything, I'd rather announce a lower one, but I--

MS. TEETERS. Where is it now--11 to 18 percent?

CHAIRMAN VOLCKER. Well, 12 to 16 percent happens to be where it is now. [Not changing it] in some sense just doesn't raise a question. I surely would feel uncomfortable about raising it.

MR. PARTEE. Then why don't we widen that range again to where we like it and make it 11 to 16 percent?

MS. TEETERS. With a billion dollars of borrowing.

MR. PARTEE. A lot of Committee members would like a wider fed funds range and this seems an ideal time to do it, consistent with those desires, Mr. Chairman.

MR. BLACK. Widen it at both ends?

MR. PARTEE and MS. TEETERS. No.

CHAIRMAN VOLCKER. I'm not among those who are enamored of an enormously wide range, but I wouldn't object to that. Well, let me throw something like this out on the table: Something around 8 percent for M2; something close to, say, "B" for M1; and 12 to 16 percent for the funds rate range--I don't feel strongly about 11 to 16 percent; and for borrowing let's say \$1.1 billion, just to pick a figure out, to start the path off. The operational question is whether we build into the path some allowance for a bulge in April. If we do and it doesn't appear, then we get the borrowings dropping pretty fast.

MR. AXILROD. That's what I was going to mention, Mr. Chairman.

CHAIRMAN VOLCKER. I guess we can make it asymmetrical, if we want to.

MR. AXILROD. Well, we could go whichever way the Committee wants. What we have proposed is given in the Bluebook, which would be allowing for something like 8 or 9 percent [M1 growth] in April to start with and zero in May. But if the first week or two in April seems weak rather than strong [relative to] the 8 or 9 percent, there would be no reason--if it were consistent with the Committee's view--not to reconstruct the path to where it would allow for 3 or 4 percent [growth] each month, as we normally would do, absent some doubts about April itself. But that would depend on getting some evidence in the early part of April.

MS. TEETERS. Steve, when does that bulge come? Does it usually come in the first weeks of April or a little early?

MR. AXILROD. Well, last year in the first week of April, M1 seasonally adjusted rose \$5.4 billion; unadjusted it rose \$17 billion.

CHAIRMAN VOLCKER. You can see the difficulty of this business just in that figure. We had a \$17 billion increase in the money supply in one week last April that came out to \$5-1/2 billion or whatever seasonally adjusted. They sit there and guess. Well, maybe this week it will be \$18 billion. Who knows when you get that big a figure?

MR. AXILROD. This year we've allowed--

CHAIRMAN VOLCKER. And they have made a good estimate if it is anywhere between \$5 and \$20 billion, I suppose. But that's going to produce all the difference between a minus and a big plus number in the seasonally adjusted figures.

MS. TEETERS. The point I want to get at is that we would know early if it is going to occur. It probably would occur early in the month of April; that is traditionally when it has happened.

CHAIRMAN VOLCKER. Well, I am not sure. Is that right?

MR. AXILROD. The earlier it occurs, the bigger the odds are on the month being high. Last year it occurred early. In 1979 the increase unadjusted was pretty large; the first week had the biggest increase but the last 3 weeks had increases, unadjusted, of about 50 percent. So, it was fairly evenly spread in 1979, looking at the unadjusted number. And in 1978 it was more in the first week.

CHAIRMAN VOLCKER. A lot of it does depend on how the tax checks are handled and that would be after the 15th. If they sit on them for a while, then we get a big increase after the 15th.

MR. AXILROD. The market is sitting around worried that the first week will be strong, largely because they have looked at last year. And, as I say, we are projecting a big increase, \$3.2 billion seasonally adjusted. If that didn't develop, and the week of the 14th weren't strong, we would get a preliminary view of that in mid-April. Then one would tend to think that it would be better [to construct the] path on a more even basis, consistent with whatever view the

Committee has as to what it wants for the 2 months. But it would take a week or two to know about that.

MR. BOEHNE. That means it would be mid to late April before we'd really get a handle on it.

MR. AXILROD. Yes, if the Committee wants to give some flexibility to--

CHAIRMAN VOLCKER. What we have now deals with hopes, but we have a minus coming up this week. We expect--we have a string of "ifs" here--if it held the following week, we would have room for some increase in the first week in April without making April high.

SPEAKER(?). That's right.

CHAIRMAN VOLCKER. But who knows whether any of it will hold?

MR. PARTEE. As you suggest this, would you visualize that we would say in the directive that we're seeking growth in M1 at a 3 percent rate from March to June? No, it can't be; that's too low.

CHAIRMAN VOLCKER. That isn't very low compared to our targets.

MR. PARTEE. It's well below, I tell you. As we say, we are prepared to take 5 percent or so when we are running in a current state well below what we say our target ranges are. I'm prepared to give up. I'm prepared to concede the winter as being a NOW account surge if it doesn't go away.

CHAIRMAN VOLCKER. Yes, if it doesn't go away. But how do we know that it is going away?

MR. PARTEE. But if it goes away, we ought to be running a steady state that is closer to our target ranges.

MR. FORD. Yes, but Chuck--

VICE CHAIRMAN SOLOMON. Yes, but if we also say M2 around 8 percent and the staff builds that operationally into the path, coming out with a path that's somewhere between "A" and "B" is not as restrictive as the 3 percent.

MR. PARTEE. But M2 has very little effect on the path.

VICE CHAIRMAN SOLOMON. Well, [unintelligible] deal more.

MR. GRAMLEY. Is the path that we are building one that says a 9 percent increase in M1 in April and a 10 percent increase in M2? If so, I'm not worried too much about the words.

MR. PARTEE. Yes, I would buy that.

MR. GRAMLEY. I am worried about the substance of your argument. I think 3 percent as a target for the second quarter assumes that we are going to get a reversal of this build-up in OCDs, and I am not at all sure that that is going to take place. And I

don't want policy to follow a course that is going to push up interest rates if that doesn't happen. On the other hand, if we have a path based on a 9 or 9.1 percent increase or thereabouts for M1 in April and a 10 percent increase in M2, then we can come back next time and look at it again. Maybe that--

MR. PARTEE. Yes, I agree. But I thought we were wavering on what we were going to build into the path.

MR. GRAMLEY. Yes, that's what I wanted to be sure of.

MS. TEETERS. Are 3 percent for M1 and 8-1/4 percent for M2 compatible? The 3 percent M1 [in the Bluebook alternatives] has 7-1/2 percent M2.

MR. AXILROD. Well, that's what we have in there. That assumes a decline in growth in the nontransactions component of something more like 9 percent. That is a drop from the rate of growth we have in the first quarter. If that doesn't happen, then I'd say it's more like alternative A. So, again, it depends on how much scope the Committee, in its own judgment, wants to leave.

MR. GRAMLEY. The thing that I think we need to worry about now is the phenomenon that happened last summer. In putting more attention on M2, I think we let more constraint develop on the economy ex post than we wanted. And Governor Partee was reminding us over and over again that we were going to do that. I wish I had listened to him then. I think that's something that we have to be careful about in April. If the M1 number happens to come in at 3 percent, let's say, one could easily interpret that as no bulge. But in fact if the economy was weakening and the signals of economic weakness were gathering [momentum], then we would be sitting back and accepting 3 percent and it would just be the wrong thing to do.

MR. PARTEE. Then we'd have a quite weak May and June.

MR. GRAMLEY. Yes.

MR. PARTEE. That's right.

MR. CORRIGAN. But if the NOW accounts were starting to unwind, 3 percent wouldn't be the wrong thing to do.

MR. PARTEE. That's right.

MR. GRAMLEY. If that were happening and if we had a fairly significant continuing growth of currency and demand deposits and M2 and the OCD phenomenon began to unwind, then I wouldn't worry too much about it, particularly if it were not accompanied by further signs of developing economic weakness.

CHAIRMAN VOLCKER. We don't know the meaning of that April phenomenon. We'd have a very strange result if M1 in April were going up by 9 percent and M2 were going up quite a lot and we got an easing market.

MR. GRAMLEY. Can we take a vote just to go right on to May instead of all this?

MR. BLACK. Let's stick to the one we all can agree on!

MR. FORD. I like the combination that you cooked up here, Paul, if I understand it correctly. You are saying to the Desk, as I would interpret it, to anticipate unusual growth in M1 and don't get excited about it unless both M1 and M2 get completely blown away, with a very high M2 growth rate and an M1 that was going over the estimate that's built in. The Committee would be saying, as I understand you, start to close in on the path and come back to the path fairly rapidly only under those conditions--if both M1 and M2 were being blown away. On the other hand, also resist, if it turns out that the professors and Arima are right, and you find that early in April the money supply is fading away on us. Don't necessarily just sit by with that either and let us get a collapse.

CHAIRMAN VOLCKER. Well, wait a minute. I think I'm saying the first half of what you are saying. The second half is--

MR. FORD. You wouldn't mind?

CHAIRMAN VOLCKER. I wouldn't mind M1 coming in lower than that. I tell you, I'd be delighted if M1 came in lower than 9 percent. And if M2 were coming in around 8 percent, that would be fine. I wouldn't react to that all that quickly. I would lower that bulge path because the bulge didn't take place. And then if we get weakness coming into May, that's the time to ease.

MR. BLACK. I think we ought to consider leaving that sentence in the directive that we debated about and put in last time, to implement that thought you just expressed, Mr. Chairman. We said in effect that some slowing in the rate of M1 growth, associated with reduced pressure in the money market, would be okay.

CHAIRMAN VOLCKER. Well, by coincidence or otherwise, I wrote that sentence in myself. That is what I am saying. Just to clarify the issue: Let's cite this "A" and "B" combination for the quarterly target and say \$1.1 billion in borrowing, which raises the path from where we now have it. It says, okay, tentatively construct the path, believing in a bulge in April. If the bulge appears, we have no tightening of that general magnitude. If the bulge does not appear and M2 growth is running reasonably high, we change the path to make it a more even path. If M2 is running weak, we may keep the path up there.

MR. FORD. And do you go for this widening of the funds rate band to 11 to 16 percent?

CHAIRMAN VOLCKER. Ipsy-pipsy, so far as I'm concerned.

VICE CHAIRMAN SOLOMON. I'm a little worried about the market perception when we narrow or widen the range--I'm not talking about the absolute levels now at all--because the market attributes much more significance to our narrowing or widening that range than we do. We don't really give it much significance. But market observers don't understand why we would be narrowing or widening the range unless it's of some importance to us. I have heard recently views that we are keeping the fed funds rate within a very narrow range in terms of actually looking at the market behavior. So, I don't particularly

care, except that if we want to de-emphasize the constraints that are implied by the range, we ought to try, if at all possible, not to keep shifting back and forth between a narrow range and a wider range.

CHAIRMAN VOLCKER. Well, on balance, I agree with that argument. My own attitude would be that if the federal funds rate began going below 12 percent, consistent with everything we have said, I would be in favor of a two-second consultation or none at all. If it began going up in the 16 percent area, I'd be extremely worried.

MR. GUFFEY. First of all, let me say that I'm attracted by your proposal with respect to the aggregates and the implications for constructing the path. But it does bother me a bit that you are proposing to drop the borrowing level from about \$1-1/4 to \$1.1 billion. Actually, this week the [target] level is \$1.4 billion. My concern stems from--

CHAIRMAN VOLCKER. How is it running this week, by the way?

MR. STERNLIGHT. It's averaging \$1.2 billion so far this week.

MR. GUFFEY. But the path has \$1.4 billion.

MR. STERNLIGHT. But \$1.4 billion is--

MR. GUFFEY. And it has been greater than that over the intermeeting period, hasn't it?

MR. STERNLIGHT. Over the last several weeks borrowings averaged about \$1-1/4 billion; in the preceding several weeks it was more like \$1-1/2 billion.

CHAIRMAN VOLCKER. Where is the funds rate today?

MR. STERNLIGHT. Funds today are at about 15-1/4 to 15-3/8 percent. I think the rate is being affected by these pre end-of-quarter statement date pressures.

MR. GUFFEY. Well, my concern about dropping the borrowing level at this particular time is the perception in the markets; they are expecting a big bulge in April. Whether they are right or not is all speculation, but the fact of the matter is it will be visible very soon after this meeting that the borrowing level has dropped from the prior week's level. And it would not be uncommon if [market participants] arrived at the conclusion that we had met and that we had eased in the view of a very large bulge in the money supply in prospect. As a result, I like very much your proposal for the aggregates, but I'd rather have the borrowing level remain about where it is at the present time until we see some additional developments. The path should be constructed on about \$1-1/2 billion of borrowings.

CHAIRMAN VOLCKER. Well, you have a point. I don't know whether I'd worry about it or not. Mr. Solomon characterized our proper attitude earlier as alert but relaxed, or relaxed but alert. Maybe it would take some of the steam out of all this worry about April if they felt we were indeed a little relaxed. I don't know.

MR. GUFFEY. But if you give--

CHAIRMAN VOLCKER. I suspect the difference is so small that they won't notice it much because they haven't seen \$1.4 billion recently.

VICE CHAIRMAN SOLOMON. Also, there is a special situation in the market whereby in the last few weeks the fed funds rate has come in almost consistently higher than one would expect from the level of borrowing. So, therefore, probably with \$1.1 billion we will get about 14 percent with today's conditions. I don't think the market would see that as terribly significant. The funds rate has been averaging about 14-1/2 percent, fluctuating between 14-1/4 and 14-3/4 percent roughly, in the last few weeks with that borrowing level of \$1-1/4 billion. So, I don't think we would see that much movement in the fed funds rate.

MR. BLACK. I share Roger's concern. I think he expressed it very well.

MR. FORD. Well, you said \$1.1 or \$1.2 billion. Why don't we put it at \$1.2 billion and everybody might be happy?

MR. GRAMLEY. I strongly would prefer \$1.1 billion.

MS. TEETERS. We can afford some easing. You know, we are really at the bottom of the recession. I don't see why you are so enamored of keeping interest rates in the 13 to 15 percent range. And it certainly won't help the international situation. We are really ruining ourselves with the rising value of the dollar as far as our exports are concerned. We could afford some narrowing of those differentials in the international market.

MR. BLACK. Nancy, my concern is not with the short-term rates, but what I think it might do to the long-term rates.

MS. TEETERS. The long-term rates haven't moved at all.

MR. BLACK. They're moving down to some extent.

MS. TEETERS. There are still 17 percent rates on mortgages.

MR. BLACK. They're higher than I want to see them, and I surely would like to see them come down. But if we relax much, we may see them go the other way and that would be really bad at this point.

MR. PARTEE. I can't really imagine, Bob, whether we choose \$1.1 or \$1.2 or \$1-1/4 billion for the initial borrowing level, that it is going to affect long-term interest rates.

MR. BLACK. Well, I think a lot of that is psychological, Chuck.

MR. PARTEE. They won't even know what we have decided here until the middle of May and then it will all be history.

MR. BLACK. Well, they will know what the figures are coming in at. Last week borrowing was \$1.3 billion, and if we come in

anywhere near \$1.1 billion, in view of their expectation that we will have a bulge in April. I think that will be interpreted as Roger expressed it. I may be wrong; it's just my feeling. I think we really have them believing us now, and we have to appear to be moving against that bulge if it's greater than the market is expecting it to be. I'm hoping and rather expect that it's not going to be as big as the market thinks and that we might even have short-term rates coming down. I hope that happens, but--

CHAIRMAN VOLCKER. Well, what I wouldn't particularly like to see happen--but we can't play it all that finely--is to have the market rally a little and the short-term rates go down and that lasts three weeks and then goes back the other way.

MR. BLACK. Yes, I wouldn't want to force it down; but if that falls out as a result of the aggregates being within what I would consider a reasonable range, I would certainly welcome that.

CHAIRMAN VOLCKER. If we don't get a bulge in April, I suspect we will get a rally in the market regardless.

MR. BLACK. Well, I think so too. And I hope that's what happens.

VICE CHAIRMAN SOLOMON. Why don't we flip a coin?

MR. BOEHNE. Well, on the argument between \$1.1, \$1.2, \$1.3, and \$1.4 billion, if you go back over the last few weeks, adjustment borrowing in billions has been \$1.1, \$.99, \$.97, [\$1.2], and the last week in February it was \$1.5. I didn't see the market falling out of bed one way or the other.

CHAIRMAN VOLCKER. You're looking at different figures. I get confused by that, too. You are looking at pure adjustment borrowing. Apparently the figure we use is adjustment borrowing plus seasonal borrowing.

MR. BLACK. That's right.

CHAIRMAN VOLCKER. So, you have to add \$150 million or so.

MR. BOEHNE. Well, I think the main point about variability in the level is still there.

CHAIRMAN VOLCKER. I think your point is right. But we are a little lower relative to the recent average than those figures say. I don't think [the difference] is big enough to be terribly noticeable.

MS. TEETERS. But the point is that interest rates also have been a full percentage point higher than we anticipated with the level of borrowing over this period of time. So, there's a tighter market with that level of borrowing than we thought there was going to be.

MR. BLACK. But we knew we were guessing at what the rates would be at the time we projected that.

MR. PARTEE. What are the borrowing numbers? Now I'm totally confused. What has been the recent record of borrowing that we are associating this beginning number with?

MR. STERNLIGHT. I believe the last several weeks averaged about \$1.26 billion or something like that.

MR. AXILROD. In the eight-week intermeeting period, the average was \$1.4 billion. But the average has been a little lower in March. March 3rd was \$1278 million; March 10, \$1141 million; March 17th, \$1163 million; and March 24th, \$1343 million.

MR. BALLE. Steve, that's just the grand total excluding the extended borrowing?

MR. AXILROD. Yes.

MR. BALLE. Okay.

MR. PARTEE. Well, that \$1-1/4 billion sounds fine.

MR. CORRIGAN. So, in those four weeks it averages to about \$1.2 billion.

MR. AXILROD. That's right. So, the aggregates strengthened when the borrowings were rising.

CHAIRMAN VOLCKER. Well, the difference between \$1.1 billion and \$1.2 billion is not going to make or break me. I think the lower we go the more quickly we may have to snug up a little if April comes in high. So, you play one of those off against the other.

VICE CHAIRMAN SOLOMON. We have a little more room with \$1.1 billion if April comes in high.

CHAIRMAN VOLCKER. You can argue that we'd have a little more room [to tighten], that's right. We have to show a little more motion--

MR. WALLICH. It may be giving a false signal; the rate may go down first and then [go back up].

CHAIRMAN VOLCKER. Well, I think that is what it comes down to. We have to balance a small chance of a false signal against buying ourselves a little more flexibility by moving [borrowing] up again. It is not driving things through the ceiling. I'm not dying to give false signals, and that is a consideration if [the bulge] is going to be temporary. We have more room for flexibility and false signals; [we'll have] real signals once they get that budget in place.

MR. FORD. Let's not hold our breath waiting for that!

MR. BOEHNE. Well, what difference would it make in the funds rate, Steve, with a borrowing range from \$1.1 to \$1.2 billion?

MR. AXILROD. Well, on our rule of thumb, either 20 or 25 basis points, and that's [likely to be] wrong.

MR. BOEHNE. We're getting carried away with our own inability to be precise here.

CHAIRMAN VOLCKER. And it's not going to make that much difference. We're playing at the margin.

MR. BLACK. Well, the big difference is in expectations, I think.

MS. TEETERS. What is your proposal again?

MR. FORD. Make a proposal, Mr. Chairman.

MR. CORRIGAN. It depends on whether we get the bulge or we don't get it.

CHAIRMAN VOLCKER. The proposal is to put in around 8 percent [for M2] and around 3 percent [for M1]--either "around" or "about," one of these terms of art that we use--for the quarter as a whole. And I'd slightly prefer just staying with the 12 to 16 percent funds rate range because that's where we are and recently we have been about in the middle of it, roughly. I'd make one wording change. I'd say "probability" instead of "possibility" in this sentence that's proposed: "The Committee also noted that deviations from these targets should be evaluated in the light of the probability..." That suggests a little more weight on the M2 number. I also thought of putting in some sentence, as Bob Black suggested, to the effect that a shortfall of M1 growth, consistent with progress toward the upper part of the range for the year as a whole, would be acceptable in a context of appreciably reduced pressures in the money market, which is very similar to what we had last time. Operationally, what I am saying is that we tentatively allow for some bulge in April in making the target. In other words, the borrowing would not go up with an [M1] increase in April of a magnitude of 9 percent at an annual rate, which I guess is what Steve is suggesting. I gulp a little at something that big, but that's what he said. I'll take it. That's what we would do if M2 in fact is somewhere around this number that we are talking about.

MR. GRAMLEY. But the number we use for M2 for April is not the quarterly average, presumably.

CHAIRMAN VOLCKER. Well, I was thinking of that.

MR. GRAMLEY. If we get a bulge in M1, then presumably M2 is going to be higher also, since M1 is a big component of M2. In fact, what is consistent with 9 percent in M1 is about the same or a little bigger M2 growth, is it not?

MR. AXILROD. If you took the alternative A path, we have 9-1/2 percent for M2 in April.

VICE CHAIRMAN SOLOMON. I think Lyle has a good point that we wouldn't want to apply the M2 directive factor, so to speak, on a quarterly basis. We would have to see a stronger growth in April in M2 before we clamped down. And if we're targeting a 9 percent increase in the nonborrowed reserve path for April--

CHAIRMAN VOLCKER. Theoretically, all else being equal, that is right. I don't know what it amounts to quantitatively when M1 is \$400 billion and [its growth] is 6 percentage points high relative to the quarterly target, 6 percent or $1/4$ of the whole, less than $1/4$, $1/5$ of the whole, 6 percent at an annual rate. I don't know what that amounts to. What is 6 percent of 20 percent? I guess it's about 1 percent.

MR. PARTEE. Yes, it's probably about $1-1/4$ percent, I think.

CHAIRMAN VOLCKER. I will moderate my comment by saying for the month of April "around 9 percent" is set for M2; it begins to get me a little nervous, but I guess that's all right. Now, I lost the context of where I was. We have that path for M1; if [its growth] just for the month [of April] is around 9 percent, we hold to it. If it's above that, the suggestion is that the borrowing level would go up. If it is below that, and M2 is also around--I guess in this case someplace between 8 and 9 percent, depending upon how much M1 is below--we might not ease up on those borrowings very much at all until we saw M2 coming in low too, so long as M1 were around the 3 or 4 percent area. If M2 began actually going minus, we would be easing up; or even if it went below 3 percent, we would be easing up.

MR. CORRIGAN. But in that case, doesn't that mean that the path effectively would have to be redrawn?

CHAIRMAN VOLCKER. Yes, depending upon what M2 is doing we'd have to be redrawing the path. If M2 were weak and M1 were coming in at 9 percent or maybe even higher, we would accommodate it.

MS. TEETERS. Will we have enough information to know what M2 is doing during the month?

MR. AXILROD. Well, we do now get weekly M2 data.

MS. TEETERS. We do?

MR. AXILROD. We have shifted over to that through the Monetary Control Act data, so we have--

CHAIRMAN VOLCKER. By the middle of the month or a little after the middle of the month we should begin getting an idea.

VICE CHAIRMAN SOLOMON. Do you mean that if somebody filed a Freedom of Information Act request, you'd have to give [the data] to them? You prepare a weekly M2?

MR. CORRIGAN. Not if we are quiet!

MR. AXILROD. We certainly don't do it in anything except a tentative experimental way.

CHAIRMAN VOLCKER. For the record we do not prepare a weekly M2 number, but we get some hints as to where it might be in terms of trends. We do not have a weekly M2 number.

MR. AXILROD. Not seasonally adjusted.

MR. GRAMLEY. There's a danger, I think, in this operational prescription, and that is that if the economy weakens and the demand for M1 weakens correspondingly, so long as M1 growth is above 3 percent, we would proceed to adjust the path downward. But we would keep initial borrowing where it is and interest rates where they are. If the source of this weakness in M1 is a weakening economy, we have big problems.

CHAIRMAN VOLCKER. Well, wouldn't you expect to see that a little in M2?

MR. GRAMLEY. In one month? I don't know. It seems to me that the shifts in demand for M2 are sufficient so that it may or may not.

CHAIRMAN VOLCKER. Well, I don't know what we're going to know from a weakening in M1, either, for a couple of weeks.

MR. PARTEE. I would have thought that we would want to look more at what NOW accounts were doing.

CHAIRMAN VOLCKER. Well, I'd certainly look at that within that total, too. But I suspect this early part of April is going to be so mixed up that we won't be able to make anything out of it.

MR. GRAMLEY. I would hope, though, if we saw an M1 number that was coming in around 3 percent, that we would want to have a consultation to make sure that we are following procedures that make sense in light of what we see going on in the economy.

CHAIRMAN VOLCKER. Well, around 3 percent is a flex point in terms of this prescription I had. Unless M2 looked pretty strong, we probably would begin easing, just in terms of what I said. If M2 looked strong, we would not [ease], taking literally what I said.

MS. TEETERS. If M2 comes in weak, would you tolerate a higher level of M1?

CHAIRMAN VOLCKER. Yes.

MR. PARTEE. Higher than what?

MR. RICE. Like 5 or 6 percent.

CHAIRMAN VOLCKER. Well, higher than 9 percent even at some point, if [M2] is weak enough. I think that's what we are saying.

VICE CHAIRMAN SOLOMON. That's giving a lot of flexibility.

CHAIRMAN VOLCKER. It comes into that application of judgment that somebody made a plea for.

MR. GUFFEY. I assume this all contemplates a consultation before the paths would be redrawn, based upon the data that you have just described.

CHAIRMAN VOLCKER. Oh, I don't think so, necessarily. But if there were any confusion about it, we might well do it.

MR. GUFFEY. I would hope so.

CHAIRMAN VOLCKER. I think we are talking in the first instance about a very small change.

VICE CHAIRMAN SOLOMON. Yes, if it's a very minor adjustment we don't need a consultation to do it. If it's a significant adjustment, then there's an advantage to having a consultation.

CHAIRMAN VOLCKER. Sure. We're talking here in the first instance about adjustments of \$100 million or so.

MR. CORRIGAN. Well, if M1 is between 3 percent and 9 percent you're talking a minor thing, but if--

CHAIRMAN VOLCKER. Oh, yes.

MR. CORRIGAN. In the extremes--if it's greater than 9 percent or less than 3 percent--it's not minor.

CHAIRMAN VOLCKER. If M1 is coming in at 15 percent or at minus 5 percent or something--

MR. PARTEE. Which is probably what it will be doing.

SPEAKER(?). Yes.

CHAIRMAN VOLCKER. It well might. I would not discount either of those possibilities.

MR. BOEHNE. Well, there are so many "ifs" here and we are not going to nail them all down or even come close to it. I think we simply have to have confidence in the Chairman's good faith and good judgment to get the Committee back together to take a look at the situation if too many of these "ifs" begin to pop up.

CHAIRMAN VOLCKER. I must say that I think we have nailed them down beyond what the situation probably can stand. If we do that, there has to be a certain reliance on judgment. I agree with that.

MR. PARTEE. Operationally, you are going to put in 9 percent for April?

CHAIRMAN VOLCKER. At this point.

MR. PARTEE. And we are going to start with what initial borrowing level?

CHAIRMAN VOLCKER. Well, I guess I didn't get to that point. There is some disagreement about \$1.1 or \$1.2 billion. I can live with either.

MR. FORD. Well, why don't you name one and let's vote on it?

MR. PARTEE. Make it \$1.150 billion.

CHAIRMAN VOLCKER. Well, that's an obvious solution. Why don't we put in \$1.150 billion. That's my solution.

SPEAKER(?). I'll vote for that.

MR. CORRIGAN. That's a variation of Partee's law, isn't it?

CHAIRMAN VOLCKER. That's a beautiful solution. I was going to ask for preferences, but--. Partee's solution is never quite right but it's just a little bit wrong all the time!

MR. BOEHNE. It's never right but always wrong.

MR. PARTEE. Well, it's never entirely wrong, either!

VICE CHAIRMAN SOLOMON. You know the Solomonic decision is to cut the baby in half.

MR. AXILROD. Mr. Chairman, just so I understand the M2 for April. Left to our own devices, if the Committee adopted 8 percent for M2 growth, we would put in a 9-1/2 percent for April and a 7-1/2 percent for May. That's what falls out of our patterns.

CHAIRMAN VOLCKER. I'd put it a little lower in April. It is just so close, what difference does it make? Put in 9 or 9-1/2 percent; you are not going to judge it that finely anyway halfway through the month.

MR. AXILROD. No.

CHAIRMAN VOLCKER. All right. Is it understood or shall I run through it again?

MR. BLACK. Is the M2 figure 8 percent?

CHAIRMAN VOLCKER. For the quarter, it's "around" 8 percent.

MR. BLACK. Oh, that's okay. That's March to June you are talking about?

CHAIRMAN VOLCKER. I interpret "around" to mean that I would not be very upset if it went a little above 8 percent for the quarter.

MR. BLACK. I would not be either on that [aggregate].

CHAIRMAN VOLCKER. I'd put it at 8-1/2 percent, but that's fine-tuning too much. I don't have to repeat it again. What it amounts to is: With something between 3 and 9 percent on M1, we look very hard at M2. And we look at M2 when we are outside the range there, too, as to how hard to move, but we would move [if it were] outside that range. I think that's what it means in practice. That great discrepancy between 3 and 9, 6 percent at an annual rate, is judging the money supply within one half percent a month. We have allowed ourselves all of \$2 billion leeway.

MS. TEETERS. How often do we hit our April projection?

VICE CHAIRMAN SOLOMON. How often do we hit any projection?

CHAIRMAN VOLCKER. Well, actually I meant to comment on that earlier and I did not. I just want to take note of the fact that for this period since the last meeting, which was exceptionally long, we came about as close to the M1 and M2 targets as I can ever remember.

MR. BLACK. M1 too.

CHAIRMAN VOLCKER. Yes, both M1 and M2.

MR. CORRIGAN. A sign of things to come, Mr. Axilrod?

MR. BLACK. At one point. Don't count on that, either.

MR. PARTEE. That, however, probably increases the odds that we'll be wrong in the future.

CHAIRMAN VOLCKER. Probably. Shall we vote?

SPEAKER(?). Yes.

CHAIRMAN VOLCKER(?). If I delay 30 seconds, we can have the vote at 1:00 p.m. Ready?

MR. ALTMANN.

Chairman Volcker	Yes
Vice Chairman Solomon	Yes
President Balles	Yes
President Black	No
President Ford	Yes
Governor Gramley	Yes
Governor Partee	Well, I'll say "yes" one more time
Governor Rice	Yes
Governor Teeters	Yes
Governor Wallich	No
President Winn	Yes

CHAIRMAN VOLCKER. Okay, thank you.

END OF MEETING